Don't Take It; It's Mine

Enforceable nonpiracy agreements protect the business interests of both agencies and agents.

by Gary Miller and Todd Zucker

Owning an insurance agency without having in place nonpiracy agreements with the producers is like renting an insurance agency. Building an insurance agency is about building a book of business, and the value of the agency depends not only on the size of the book of business, but its stability as well. Agencies spend considerable time and money helping producers develop a book of business, but if the producers are free to come and go as they please with the expirations and relationships they control, the value of the agency belongs to the producers and not to the owners.

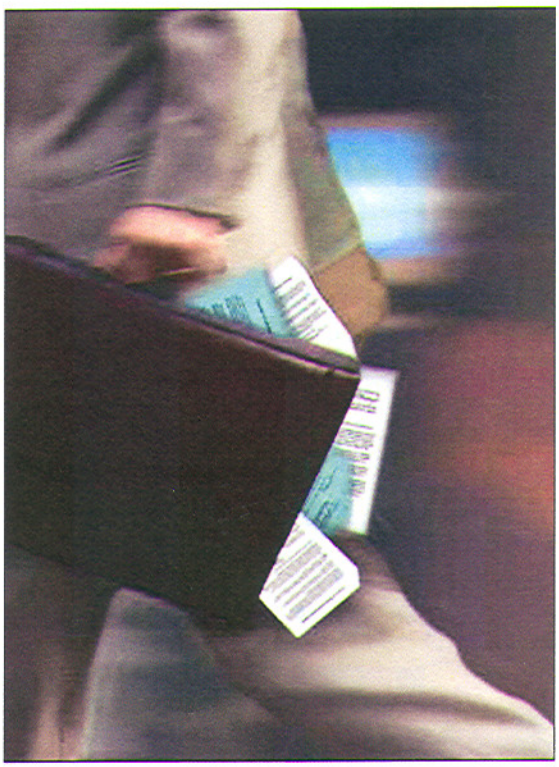

Photo Illustration by Angel M. Negron

The best time to think about protecting the agency's most valuable asset is when each new producer is hired. It is much easier to negotiate sensible nonpiracy arrangements at the front end of the relationship. It is far more difficult to impose protective measures once a producer becomes disgruntled or has decided to leave the agency, and the options are much more limited at that point. Also, if an agency is to be sold, the buyer will expect to see enforceable nonpiracy agreements in place to protect the goodwill that justifies the purchase price.

A nonpiracy agreement is a limited form of a non-competition agreement. A typical non-competition agreement prevents an employee from competing in the same business in a specific geographical area for a limited period of time after the employee's employment is terminated. In many instances, however, an insurance agency is not concerned about keeping its former producers from selling insurance altogether; instead, it simply wants to keep the former producer from taking the customers of the agency when the producer moves to a new job. In these cases, nonpiracy agreements are a good solution. They are less onerous to employees and are usually viewed more favorably by courts than traditional non-competition agreements.

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Owners Keepers

Few professionals are more mobile than insurance agents. All that is needed in terms of equipment is a phone, a computer and a desk. The agency, however, requires office space, furniture, infrastructure, underwriter contracts, customer service representatives, secretaries, administrators, working capital and more. In short, it is expensive to build and run an agency, and the agency, therefore, has a legitimate motivation to protect the book of business produced by its agents. Being subject to an effective nonpiracy agreement provides a successful producer additional incentive to stay, since leaving the agency necessitates starting over

Key Points

- A nonpiracy agreement prevents a producer from taking the customers of the agency when the producer moves to a new job.
- If an agency is sold, a nonpiracy agreement can prevent the seller from competing for the same business immediately after selling the agency.
- Customer service representatives should also be asked to enter into nonpiracy agreements.

again. If a key producer can leave with his or her business, not only will the annual income of the agency be affected if the producer departs, but the price a potential purchaser will pay for the agency might be dramatically reduced as well.

Many agency owners think about their book of business in terms of the agency's ownership of the client accounts and expirations—something the agency "owns" in perpetuity. However, while the agency might own its books, records and trade secrets, and while insurance industry players might embrace the concept of ownership of expirations, the law technically does not recognize "ownership" of customer relationships. Instead, the law in most states (albeit to varying degrees) merely protects against competition for those relationships in appropriate circumstances.

For example, an employer that provides an employee with a competitive advantage through specialized training or specialized knowledge, or through a substantial investment in the employee's business pursuits, has a legitimate reason to prevent the employee from abusing that competitive advantage after the employment relationship terminates. Courts recognize that, without restrictions against competition, an agency's most valuable asset would leave when the producer leaves, and employers theoretically would be less likely to invest in their employees.

The proper method for protecting the agency's customer relationships in these circumstances is to create an enforceable non-competition or nonpiracy agreement, instead of attempting to decide who "owns" the expirations or book of business. Even in the context of a sale of an agency or its assets, there is no actual transfer of "ownership" of customer relationships—without enforceable non-compete or nonpiracy agreements in place, the seller has the right to compete for the same business the very next day after selling the agency.

The Enforcer

While many employees have been told that non-competition agreements are not enforceable ("They can't take away my livelihood, can they?"), in truth, carefully prepared and constructed non-competition agreements are enforceable in many types of employment relationships in most jurisdictions. Creating an effective and enforceable nonpiracy agreement is a matter of state law for the particular state in which the employer and employee are located.

In Texas, a bare nonpiracy agreement will not be enforceable; rather a nonpiracy agreement must be related to a larger agreement. For employee nonpiracy agreements, the larger agreement might involve a guarantee of employment for a fixed term in which the employee will build personal relationships with customers. In the context of a nonpiracy agreement between agency owners or one related to the sale of an agency, the larger agreement involves either a buy-sell between the owners or an agreement to sell the agency's goodwill for a negotiated purchase price.

The agreement must also be reasonable as to duration, territory and scope, so thought should be given to the minimum restraints necessary to provide the necessary protection. In Texas, the statute setting forth the requirements for non-competition agreements applies to employers generally and does not specify requirements for a particular trade or profession (with the exception of licensed physicians). There is no magic formula for creating an enforceable non-competition or nonpiracy agreement, and the duration, territory and scope will differ depending on the unique circumstances of the employer and the employee.

Producer agreements used by Texas insurance agencies often have nonpiracy agreements providing a duration for the nonpiracy covenant of two years after the term of employment ends (although the two-year duration is not per se enforceable); a territory that includes the counties in which the customers of the agency are located; and a restriction against directly or indirectly selling insurance to the customers with which the producer had personal contact while at the agency. Nonpiracy agreements used by agencies in buy-sell agreements might have broader protections.

In any event, when it comes to enforcing any nonpiracy agreement, the agency should be prepared to establish that its scope is reasonably necessary to protect the agency's legitimate business interests. In the agreement containing the nonpiracy covenant, the agency also should include a strong confidentiality agreement. While most states have common law rights with respect to an employee's obligation to maintain in confidence the proprietary information of the employer, a confidentiality agreement can be of significant help to an agency when a key employee departs.

Seasoned Agents

It might not be difficult to convince other owners in a multi-owner agency to sign nonpiracy agreements, because the owners expect to receive compensation for their stock if they retire or the agency is sold. Likewise, new agents just starting out often will sign a nonpiracy agreement without a fight, because they recognize the investment that the agency is making in them to help them get started (and they also might not appreciate the significance of what they are signing). The challenge is in getting a seasoned agent making a lateral move to a new agency to sign the agreement, and often resistance is met when asking these agents to agree not to take any business with them if and when they move on.

Depending on the potential of the new hire, it might well be worth suggesting an arrangement in which the business brought by the producer to the new agency will be protected from pirating by the agency after the relationship terminates, but the agency and producer will treat the producer's new business differently. In this type of arrangement, producers might have the option to take the business with them if they leave so long as they pay the agency a portion of the commissions earned on account of that business for a fixed period. A typical

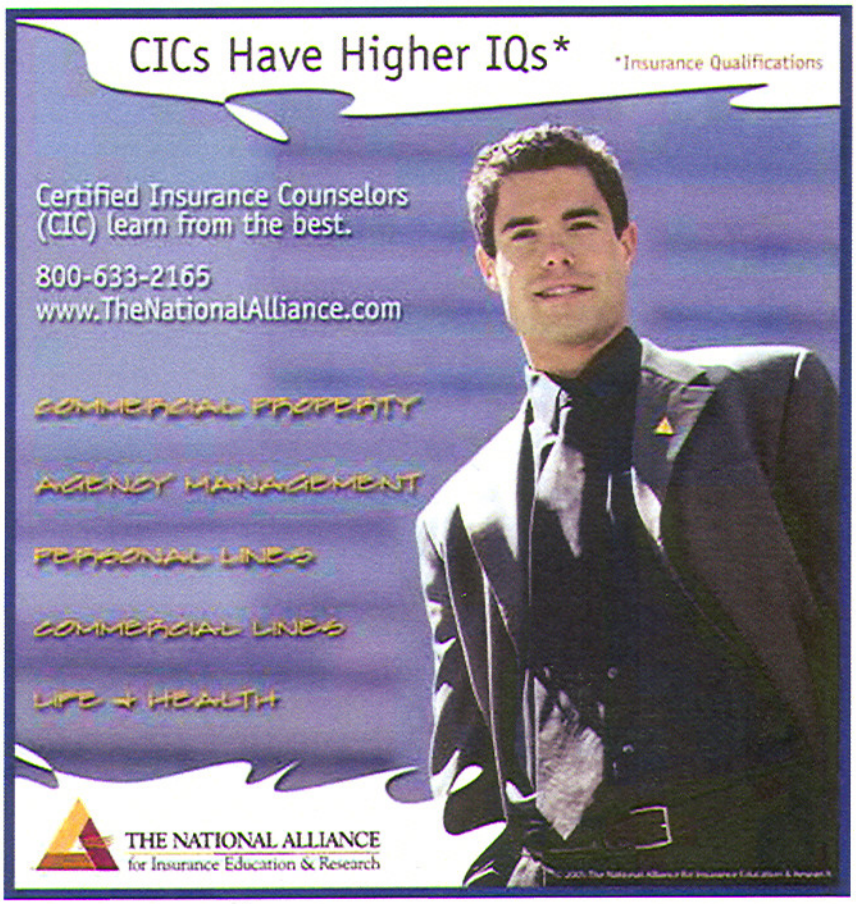
arrangement today might have the producer paying 25% of the aggregate commission for a period of five years if he or she takes the business.

If the producer does not elect to purchase the business, the agency typically would pay the producer a similar portion of the commission for the same period. In both cases, the purchasing party only pays for the business as long as it continues to write the business, and the non-purchasing party agrees not to pirate the business during the period the payments are being made plus a term of several years after the payments have stopped. With insurance being a relationship-based business, this approach maximizes the probability that the agency or the producer will retain the business, and that the party not keeping the business will be compensated.

It is not just producers who should be asked to enter into nonpiracy agreements. Customer service representatives and anyone else having significant client contact also should be of concern to the agency, because customers often have as much loyalty to their service representative as they do to their agent. On the other hand, secretaries, accounting personnel and others with limited client contact need not enter into nonpiracy agreements, as there might be no legitimate interest in preventing competition from such persons.

Given that, at least in Texas, the nonpiracy agreement must be a part of a larger agreement. The agency must make a commitment to any employee signing an agreement containing a nonpiracy covenant. As the agency signing an agreement containing an enforceable nonpiracy covenant will take on an obligation to the employee it would not otherwise have, the decision to enter into this type of agreement with an employee should not be made lightly.

Of course, nonpiracy agreements can impact not only the agency a producer is leaving, but also the agency the producer is joining. Usually, the first thing that happens when agents seek to make a lateral move is that they dust off the old nonpiracy agreement that they hardly remember signing years ago. Before an agency takes on a new lateral transfer, it is important to have any existing agreement reviewed by an attorney experienced in these matters. The attorney should be able to explain the scope of the agreement and even give the new agency a good idea as to its enforceability.

In many cases, the old agency's agreement will have overstepped the bounds of enforceability, and in such cases the new agency can employ the experienced producer without being burdened by the old agreement—although there is no guarantee the old agency will not seek to enforce even an obviously-unenforceable non-competition agreement. Oftentimes, a well written letter from the new agency's attorney to the old agency, explaining why the existing agreement is unenforceable or why its enforceability is limited will result in a negotiated settlement or a realization on the part of the old agency that it will be a waste of time and money to attempt to enforce the agreement. On the other hand, if the non-competition or nonpiracy agreement is well written, it may be time to either rethink hiring the lateral hire producer or make the hiring decision contingent upon striking a deal with the former agency.

In order to maximize the value of an agency, both in terms of annual income and future salability, effective nonpiracy agreements are a must. Nonpiracy agreements must be carefully constructed by an attorney who keeps up with the ever-changing status of the law, and who understands effective and enforceable agreements. Once an agency has lost its attempt to enforce a poorly drafted nonpiracy agreement against one former producer, the word quickly spreads to the other producers within the agency, and the deterrent value of their agreement is lost. Effective agreements, on the other hand, will likely keep all the producers from testing the waters and add to the value of the agency. BR