Agency Management

Why risk it? Effective Non-Piracy Agreements Protect Your Business

By Gary W. Miller

Owning an insurance agency does not equate to "owning" the customers it services. If the agents who have the relationships with those customers leave, the business will be at risk. It is the difference between owning and renting a business, and it's not something savvy insurance agency owners want to face without protection.

How do you fairly protect the business and attract and retain good agents? What happens to the business when and if its better producers depart for another agency? What is fair to both the agency and the agent producer?

Insurance agency owners operating without non-piracy agreements in place are putting their business at risk and likely diminishing the value of their agency in a potential sale transaction.

Building an insurance agency is about building a book of business. The value of the agency depends not only on the size of the book of business but on its stability as well. The best time to think about protecting the agency's most valuable asset is when a new producer is hired. It makes better business sense to negotiate sensible non-piracy 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.

Additionally, if an agency is to be sold, the buyer will expect to see enforceable non-piracy agreements in place to protect the goodwill that justifies the purchase price.

A non-piracy agreement is a limited form of 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. However, an insurance agency is generally 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, non-piracy agreements are the solution. They are less onerous to employees and are usually viewed more favorably by courts than traditional non-competition agreements.

Who Owns the Relationship?

It is expensive to build and to run an insurance agency and its owner has a legitimate motivation to protect the book of business produced by its agents. If a key producer can leave with his or her business, not only will the annual income of the agency be affected, but the price a potential purchaser will pay for the agency will 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.

While the agency may own its books, records and trade secrets, the law technically does not recognize ownership of a customer relationship. Instead, the law in most states merely protects against competition for those relationships in appropriate circumstances.

The proper method for protecting the agency's customer relationships in these circumstances is to create an enforceable non-competition or non-piracy agreement. 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-piracy agreements in place, the seller has the right to compete for the same business the very next day after selling the agency.

What's Enforceable?

While many employees have been told that non-competition agreements are not enforceable, 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 non-piracy agreement is a matter of state law. In some states, a bare non-piracy agreement will not be enforceable because it must be related to a larger agreement. For employee non-piracy agreements, the larger agreement may involve a guarantee of employment for a fixed term in which the employee will build personal relationships with customers as well as an agreement by the agency to provide its confidential information to the employee. In the context of a non-piracy 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 typically must also be reasonable as to duration, territory and scope, so thought needs to be given to the minimum restraints necessary to provide protection. There is no magic formula for creating an enforceable non-piracy agreement, and it will differ depending on the unique circumstances of the agency and producer as well as the state in which the agent is located.

Effective non-piracy agreements are a key component of the value of an agency.

In any event, when it comes to enforcing a non-piracy agreement, the agency must be prepared to establish that its scope is reasonable and necessary to protect the agency's legitimate business interests. Also,

it must 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 when a key employee departs.

What About Seasoned Agents?

It may not be difficult to convince other owners in a multi-owner agency to sign non-piracy 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 non-piracy agreement because they recognize the investment that the agency is making to help them get started.

The challenge is in getting a seasoned agent making a lateral move to a new agency to sign the agreement. 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, there is a solution. Consider 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 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 for a fixed period.

Another scenario: 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 that 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.

Of course, non-piracy agreements can also impact the agency a producer is joining, not only the agency a producer is leaving. Usually, the first thing that happens when agents seek to make a lateral move is that they dust off the old non-piracy 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 will 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. 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 agreement.

Often, 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 non-piracy agreement is well written, it may be time to either rethink hiring that lateral hire producer or make the hiring decision contingent upon striking a deal with the former agency. If making a deal with the former agency includes the new agency agreeing to pay a sum of money (whether up front or as the business is written), that will impact the negotiations relating to ownership of the purchased business between the agency and its new producer.

In order to maximize the value of an agency, both in terms of annual income and future salability, effective non-piracy agreements are a must. Non-piracy 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. Effective non-piracy agreements are a key component of the value of an agency. IJ

Miller is a business transaction attorney and founding shareholder of BoyarMiller, a business and litigation law firm based in Houston.