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Understanding Non-Compete Agreements

By: Dara C. Bachman and John T. Reed

Most business owners have at some time been told that they should have a "non-compete agreement" or a non-solicit agreement or some type of confidentiality agreement in place with their key employees. The purpose of such provisions can be easily illustrated by the following questions: If your head salesman left tomorrow and started his own business in your same industry, would your sales suffer? If your chief financial officer was hired by your competitor and took 3 of your 10 employees with him, would it be difficult to run your business as usual the next day? If your sous chef went to a new restaurant and divulged the recipe for the top-selling dish that packs in patrons, would your restaurant lose some of its draw?

These type of questions are enough to keep any business owner up a night because the answer is generally yes. Getting key employees to agree to provisions such as non-competes, non-solicits and confidentiality agreements is a good way to alleviate these concerns. All three may be appropriate or one or more. For this article, the importance is to understand the difference between the three provisions.

A non-competition agreement generally states a period of time and a geographic area in which the departing employee cannot own or be employed by a competing business. So, for example, if you are a distributor of dry ingredients for food manufacturers in the Mid-Atlantic region, the non-competition provision may restrict a departing salesperson from starting his own (or working for another) competing distributing business in the Mid-Atlantic region for 1 year from the date he leaves your company.

A non-solicitation agreement generally states a period of time during which an individual can not solicit the business of any customer or referral source or solicit (and sometimes hire) any of your employees. Generally, this provision will prohibit not only doing work for such customers and referral sources and/or soliciting any such employees but also attempting to get the work of the clients and referral sources and/or lure away your employees. The idea is that if you can put some time between when the employee leaves and when he can start soliciting customers, referral sources and employees, the weaker the relationship between the departed employee and those individuals and the lower the likelihood they will be persuaded to follow him to his new employer.

A confidentiality/non-disclosure agreement generally prohibits the departing employee from disclosing confidential information that, if made available to your competitors, could be used to your detriment. It could protect information such as processes, customer lists, supplier lists, financial information, or, in the case of the sous chef example, the recipe to your top-selling dish.

All three restrictions are important if a business owner is trying to fully protect his interests in the event of an employee departure. Of course, as with any legal document, just writing these terms on a piece of paper and getting it signed by the employee will not necessarily make these terms legally enforceable. Because of the way non-compete agreements interfere with an individual's right to earn a living, the courts are particularly strict as to what non-compete provisions they will enforce.

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Dispute Resolutions: Know Your Options

By: Ronald H. Pollock

It is a fact of life that disputes will occur in any business relationship. The disputes can range from small to large. While disputes are a part of doing business, a party can control how disputes are resolved through contractual agreements. Issues such as who decides, where does a dispute get heard and how quickly does it get resolved can be addressed in a contract.

Traditionally, parties involved in a contract dispute have the ability to sue each other in court. The trend today is away from the court system toward different alternative dispute resolution techniques. Confusion arises due to the multiplicity of options available through the alternative dispute resolution arena.

Before discussing the alternatives, it is worth taking a moment to examine our traditional civil litigation system. An advantage of the litigation system is that it operates strictly according to law - Judges are lawyers who learn to analyze problems through legal precedent and statute.

There are also various appeal options available to the parties which will enable them to have any incorrect legal rulings overturned. As such, if a party will rely on strong legal arguments to win it's case, the court system is often a good option.
Court systems also tend to be more black and white - there are winners and losers. A jury or a judge, whichever is utilized, will often take less of a "split the baby" compromise approach to a verdict. This is both an advantage and a disadvantage, of course, depending on which side of the dispute or the verdict one occupies.

What is certain is that the discovery process in our civil litigation system can be quite time consuming and expensive. Often, discovery costs far exceed that of the trial and other aspects of the case. This does prompt an eventual wearing down of the parties and a settlement of the dispute through negotiation, not trial and verdict.

Arbitration, on the other hand, offers some advantages of speed and informality. Generally, the discovery process is less protracted, although filing fees with certain arbitration organizations coupled with a tendency to proceed with some form of discovery process similar to the court system have tended to drive up the cost of arbitration. If an arbitration provision is desirable, and the parties truly wish to save costs as the primary goal, provisions regarding the limitation of discovery and the like should be written into the contractual ADR provision.

This ability to modify and customize the dispute resolution mechanism is a hallmark of ADR. Specifically, the parties can determine who hears the dispute (e.g., a particular industry specialist such as a panel of engineers). There is typically no appeal, which gives an advantage of finality (small consolation to a losing party however).

The parties are really limited only by their desires and imagination, although agreements that clearly overreach against one party or the other, or if one party has much greater bargaining power than the other, may not be enforced. The overwhelming tendency however is to enforce the alternative dispute resolution provisions agreed to by the parties.

ADR is not always perfect. If the parties wish to limit the provisions of the ADR process in order to save costs, they should be prepared to reap the consequences of proceeding to a hearing without a full understanding of each party's evidence. This can at times result in somewhat arbitrary results. Further, in contrast to the court system, arbitrations often can result in compromise decisions as a result of an arbitrator's attempt to be "fair," often born of their desire to operate in good faith to both parties.

Finally, a contractually mandated mediation/settlement conference can also be employed. A settlement conference is just that - the parties sit down with an unbiased mediator, skilled in facilitating compromise, in an effort to resolve the dispute without further litigation. This is often a good idea, although the timing may not be effective. For example, if it is mandated that the parties immediately have a mediation prior to any form of litigation, the mediation may in fact be premature. The parties are in a dispute - they obviously have not been able to come to terms based upon the information available to them at that time. It may require some period of litigation before the parties are able to materially change their position or modify it in order to arrive at a compromise. As such, parties should think carefully about requiring a mediation too early in the process, before the parties are prepared to compromise.

In short, ADR and trial through the judicial court system present two parallel, and at times contrasting, forums in which parties can resolve their disputes. The dispute resolution mechanism of the parties can be prestructured so that it meets the party's needs - a business can take control over the way in which disputes are resolved. There are a number of issues to consider when making decisions on the dispute resolution process. This article is far from exhaustive as to all the issues, but rather begins to provide a very basic outline of some of the factors. In later articles, we will flesh out a variety of scenarios in order to improve the understanding of this important issue, to assist you in making the right choice for your business.

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Letters of Intent: Start Your Potential Merger Off on the Right Foot

By: Paul G. Mattaini

It is advisable to start a potential merger and acquisition through the execution of a letter of intent (LOI). With limited exceptions (such as transactions involving public companies), it is usually advisable to confirm that the parties actually have a "meeting of the minds" by setting forth the most material terms in an LOI early on in the transaction process.

The argument against negotiating an LOI is that the parties may be expending time on a preliminary document when the time could otherwise be used to negotiate definitive transaction documents. However, most parties are unwilling to expend the time, effort and expense to investigate a proposed transaction without an LOI. An LOI is usually a useful guide for the negotiation of definitive transaction documents and the negotiation of an LOI can help identify points on which the parties thought they were in agreement but, in fact, were not; in some cases, the parties even realize that they are so far apart on certain issues that they, in fact, "have no deal". One final caveat is that parties can gain a bargaining advantage, or can make unwitting concessions, on key issues in an LOI which may, in effect, block negotiation of these issues later on in the process. Thus, it is always a best practice to involve a party's advisors early on in the process and certainly before execution of an LOI.

The level of detail to be included in an LOI is always a question, i.e. the parties want to include enough detail so as to address the most important deal points without getting into so much detail such that the parties instead should have moved immediately to attempting to negotiate definitive agreements.

The topics that are often included in an LOI are as follows:

Transaction Structure
- Sale of stock (includes a merger)
- Sale of assets
  > What assets are to be sold?
  > What liabilities are to be assumed?

Purchase Price
- Adjustment mechanism against a target measure, e.g. working capital?
- Timing of payment
- Form of payment
- Escrow?
- Earnout/contingent payment?

Key conditions precedent
- Financing?
- Required consents

Non-competition, employment and consulting agreements

Deal-specific terms
- Indemnification limitations
- "Social issues" such as post-closing treatment of Seller's employees
- Break-up fee
- Timing
- Confidentiality and public announcements
- Non-solicitation of other proposals (a "no-shop")
- Non-binding nature

Exceptions for expenses, confidentiality and public announcements and no shop.

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