

Ten Non-Compete Issues to Consider When Buying a Business

Insights

7.16.12



Every day businesses across the country merge and consolidate their operations. If your business acquires or merges with another business, consider these issues when drafting the agreements to make sure that you will get the benefit of your bargain.

1. **Require a non-compete agreement:** First and foremost, you'll want to prevent the owners of the acquired business from competing with you by requiring restrictive covenants. Without a restrictive covenant, the former owners can simply set up shop and compete with you immediately after selling you their company. In drafting the restrictive covenants, consider not only what type of restrictions will protect you, but also what the courts will find enforceable. In general, the prevailing test for enforceability in the sale of business context is reasonableness. For example, if the business operated nationwide, then courts will be more likely to find that a nationwide provision prohibiting competition is reasonable. However, if the company operated in a more limited area, then it may be unreasonable to demand a nationwide restriction and you may want to be more circumspect in the extent of the restriction. Either way, it is advisable to include language in the agreement indicating that the company operated in a certain geographic area and that the seller acknowledges that a restriction covering that area is reasonable and necessary.
2. **Be specific:** When drafting the noncompete portion of the deal you should carefully define the prohibited activity. Consider how the seller could hurt your business in the future and make sure that you draft the noncompete agreement to prevent activities that would enable the seller to

resume activities that would harm the company. This is normally done by delineating prohibited activities, which should include the seller not only acting as an employee in a competing business but also being affiliated with, controlling or having an interest in any competing business.

3. **Address key employees:** Are any of the principals of the business you're buying going to continue on as employees? If so then you will want to have two different agreements: one for the sale of the business and an employment agreement for key individuals. Make sure that the provisions in these agreements begin to run from the right dates. The purchase agreement should include restrictive covenants that begin to run from the closing date and the restrictions in the employment agreement should begin to run from the date that the employee's employment terminates. This will ensure that you are protected even if the noncompete associated with the sale of the business has long expired when the key employee resigns. (See [Non-competes in Fixed Term Agreements: Special Care Required](#)).
4. **Identify value:** Don't forget where the value of the deal lies. While you will likely want the sellers and upper management to sign restrictive covenants, consider whether the company would lose a lot of its value if other employees left after the sale. It may be that the real value of the company is in its sales force or research and development employees. If so, consider having those employees sign restrictive covenants in connection with the purchase of the company. In some cases, it might even make sense to offer those employees incentives to sign the restrictive covenants instead of jumping ship.
5. **Include an agreement not to recruit employees:** Do the principals of the prior business have relationships with other employees? If so, you may want to also include provisions in their employment agreements providing that they will not solicit, recruit or even hire other employees for a period of time after their employment ends. If the benefit of the deal includes the employees, you don't want the seller to act as a pied pier and lead these valuable employees away.
6. **Address assignability:** Who will have the right to enforce the restrictive covenants in the future? You may think that this should not matter to you but the restrictive covenants are important assets of your business, and you need to make sure that you will obtain the value of those assets if you decide to sell your business someday. Therefore, any successor companies must be able to enforce the covenants and protect the business. Add language indicating that the agreement is automatically assigned to a successor upon merger or acquisition to increase the likelihood that it will be enforceable. (See [Employee Retention & Attrition in Mergers/Acquisitions](#))
7. **Don't undermine your protectable interests:** Make sure that other aspects of your deal do not undermine the enforceability of your restrictive covenants. For example, restrictive covenants in the sale of a business context are generally enforceable to protect goodwill. It would undercut the claim that you needed protection of goodwill if your term sheet indicated that the value of the goodwill being purchased was zero.
8. **Make sure agreements are between the appropriate parties:** What is the structure of the deal? You will want to consider the structure because this can affect how the agreements are

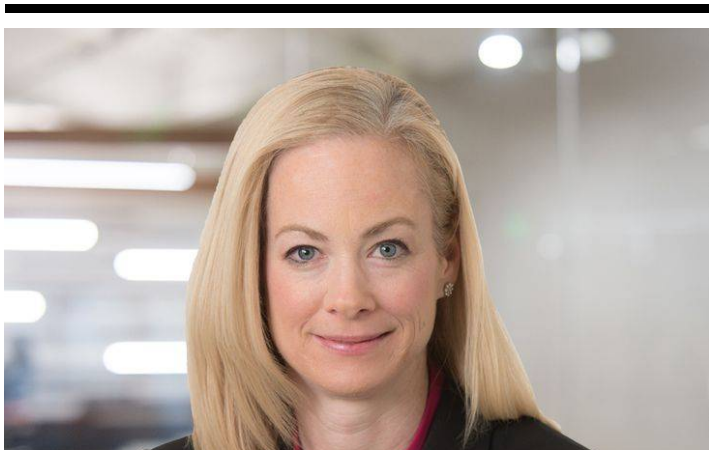
you will want to consider the structure because this can affect how the agreements are constructed. For example, if the company being purchased will be merged into the buyer, then make sure that the employment agreements are between the individuals and the purchaser. However, if the company will remain a separately existing entity, then those agreements should be with that company.

9. **Protect confidential information:** Don't forget to protect confidential information and trade secrets. In many sales, the information being purchased is a key element, but how to protect that information is not carefully considered. This is surprising given that the misuse or disclosure of that information can do a lot of damage. Make sure that the sale agreement provides that confidential information and trade secrets will not be "used or disclosed" after the sale. Also make sure that you broadly define the confidential information that adds value to the business, but do not be gratuitously overbroad.
10. **Draft agreements with teeth:** Finally, make sure that your agreements have teeth. If the seller violates the restrictive covenants and you have to take steps to enforce his or her obligations, make sure that you have included an attorney's fees provision so that the seller will have to pay the fees and costs that you had to incur in bringing litigation to stop competitive activities. Also include terms providing that the seller agrees to injunctive relief – essentially a court order requiring that the competitive activity cease – if the provisions of the agreements are violated or there is a reasonable belief that they have been or will be violated. This will help ensure that you do not have to pay more money to get the benefit of your deal.

Purchasing another business can be a great way to increase your market share, consolidate resources or buy out the competition. However, you should consider these issues when crafting your deal so that you obtain all of the benefits of your new purchase. For additional issues to keep in mind when drafting restrictive covenants, see [Top Ten Things to Consider When Drafting a Non-compete Agreement](#).

Susan Guerette is a partner in the Employee Defection & Trade Secrets Practice Group at Fisher Phillips. Susan has litigated departing broker matters for nearly fifteen years. To follow Ms. Guerette on LinkedIn, click [here](#).

Related People





Susan M. Guerette

Partner

610.230.2133

Email