



Eight Reasons Small Businesses Should Use Non-Compete Agreements

Insights

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Small business owners understandably may be reluctant to use non-compete agreements for many reasons. The desire to divert precious resources to paying an attorney to prepare a contract is hardly appealing. Similarly, businesses may feel that such agreements are unnecessary because they have few employees. But as Ben Franklin once wisely advised, an ounce of prevention is worth a pound of cure.

The term “non-compete agreement” technically refers to a contract that preclude a person from engaging in certain acts of competition for a prescribed period of time within a prescribed geographic area. In common usage, however, the term often is used more broadly to refer to any contract by which someone has any type of competitive restrictions, including non-solicit, non-recruit, non-disclosure and confidentiality agreements. Simply put, non-competes come in all shapes and sizes, but the reasons small business owners should use one or more of these covenants are equally diverse.

1. Enhance the value of your company if you think you may sell someday – If you think someday you may wish to sell your business, it is important to protect the value of your company by requiring employees to sign restrictive covenants. When someone purchases a business, they want to know that they will get what they pay for. If they believe key employees with access to customers and relationships may not stay on board after a merger or acquisition, they may balk at the price or even walk away. You may think that you can always sign employees up to a non-compete later, but such afterthought covenants present their own challenges. You can protect the value of your company and its assets by using appropriately tailored non-compete agreements.

2. Qualify for trade secret protection – Generally speaking, any valuable business information that you try to keep secret from competitors is subject to trade secret protection. But to state the obvious, to be a trade secret, the information must in fact be secret. When determining whether information should be entitled to trade secret protection, courts look at many factors including the extent to which the owner of the secret took reasonable steps to preserve its secrecy. A widely recognized precaution includes requiring employees to agree not to use or disclose confidential information. In addition, if customer information is a trade secret, a covenant not to solicit customers (i.e., a non-solicitation agreement) may well be appropriate.

3. Protect your customer relationships – Small businesses tend to place client relationships in the hands of fewer employees. Consequently, when an employee resigns, the client relationship may walk out the door with the employee. Just as importantly, you may need time to rebuild your clients' confidence and to show that your other employees are equally capable of serving their interests. Clients are the lifeblood of any business; but this is particularly true for small businesses. A small business simply cannot afford to lose its clients.

4. Enhance client confidence – Would you do business with a company if you felt your personal financial information was at risk? Of course not. Your clients feel the same way. If your clients entrust their personal or business information to you, they want to know that your employees are not going to take it when they leave. Requiring employees to sign restrictions on their use and disclosure of confidential information is a good way to make your clients confident that their data is safe in your hands.

5. Protect your investment in training – Training employees is a worthwhile expense, and the training resources you provide may even help you to attract talented employees. But steps should be taken to prevent your competitors from swooping in to hire your employees after you invest the time and expense to train them. For this reason, courts commonly recognize that employers have a legitimate interest in protecting their investments in specialized training.

6. Clarify expectations with employees – Do your employees realize that you expect them to leave behind the information you entrusted to them if they decide to move on to a new job? Do they understand that the relationships you paid them to cultivate and maintain belong to you? The best time to clarify expectations with your employees is before a dispute arises. Doing so may influence a departing employee's conduct and provide you with the leverage you need to protect your company.

7. Shape ground rules for potential litigation – Litigation against departing employees can be expensive, but when your business is on the line, you may have little choice but to protect your interests through legal action. Although no contract can eliminate the expense associated with litigation, careful forethought can help to minimize your costs. Restrictive covenants are a perfect opportunity to reach agreement with employees about some of the ground rules that will apply if litigation becomes necessary, such as whether you are entitled to recover attorneys' fees and costs if you prevail, whether lawsuits should be filed in a local forum, and whether you are entitled to certain remedies such as an injunction or liquidated damages.

8. Deter competitors from hiring your employees – Deterring competitors from hiring your employees is not a sufficient fact in and of itself to warrant the imposition of a restrictive covenant. In fact, courts will not enforce restrictive covenants if they serve no purpose other than to restrict competition. But assuming you have a legitimate purpose for requiring employees to sign such agreements – such as a need to protect confidential information or customer relationships – sending a message to your competitors that you are prepared to protect these interests is a nice side effect.

In short, there are advantages to using non-compete agreements that may not be apparent until it is too late. Small business owners should think about protecting their business in advance. Please let me know your thoughts in the comment section below.

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