The below article was published in the March, 2009 Rough Notes Magazine

Fortify Your Agency Against Eroding Value
By Christel L. Sarchet, CPA

Mike was devastated. He and Steve had been friends since college. They had lost touch for a while but ten years ago, when Steve was between jobs, Mike had offered him a position as a producer in his newly formed agency. Steve did not have industry experience but he caught on quickly, and as a result, he developed a book of business which was second only to Mike's for the entire firm. However, last month when Steve caught wind that Mike may sell the business and retire, Steve decided to leave the agency to begin his own business, taking many of his top clients with him. Now Mike was left to wonder what he could have done to protect the agency he had worked so hard to build.

In an age of increasing depersonalization of many services, the insurance industry remains largely dependent upon personal relationships. Insurance agencies in particular often find that the strength of relationships among carriers, employees, and clients, determines their ability to grow and retain their business. A reputation built upon consistently strong performance and service further enhances the ability to grow and retain business, thereby making the agency more valuable to both the owners and potential acquirers. As the fictional example above illustrates, however, the ongoing value of an agency may deteriorate quickly unless protected. One step that Mike could have taken which may have prevented the loss of business would have been to develop and implement strong employment agreements.

An employment agreement is a written contract between an employee and employer which documents the expectations between both parties. Employment agreements typically address such items as employee duties, compensation, duration of employment and termination. However, strong employment agreements for insurance agencies also include provisions which address the ownership of the book of business, non-solicitation, and non-competition. These additional provisions can go a long way in protecting the underlying value of an insurance agency, its expirations.

<u>*Ownership of the Book of Business*</u>

When Mike had confronted Steve about leaving and taking his top clients, Steve had been a little indignant and puzzled. "They are my clients!" he had said.

Insurance agencies sometimes assume that business obtained by employees will remain with the agency in the event that the employee departs from the agency. During the course of employment, employees utilize the agency's carrier relationships, existing client data, technology and various other proprietary data in conjunction with their expertise to perform their duties. A court may uphold the agency's ownership of the business. However, rather than risk any confusion on the part of the employee, the question of whether the agency or employee owns the book of business can and should be explicitly stated in an employment agreement.

Non-solicitation

With Steve's departure from the firm, Mike decided to hire Sherry, an experienced producer who had just relocated from another part of the country. Having learned from his experience with Steve, Mike requested that Sherry sign an employment agreement prohibiting the solicitation of clients obtained during her employment with Mike's agency.

A strong non-solicitation clause stipulates that upon termination the employee will not solicit or aid a future employer in soliciting the agency's clients or employees. While Mike may believe that he is appropriately protecting the agency, he should also consider including prospective clients and agency employees in the non-solicitation clause. Without also prohibiting the solicitation of prospective clients and other employees, the value of the agency could be eroded if Sherry were to leave and recruit the agency's key talent and non-clients with whom the agency had begun cultivating relationships.

Non-Competition

The goal of a non-competition clause or agreement is to protect the agency from the direct competition of a former employee working either for himself or a competitor, while not unreasonably impairing an individual's ability to obtain future employment. The enforceability of a non-competition clause may vary by state. However, the likelihood that the agreement would be upheld in a court may be enhanced by the inclusion of certain limitations.

Mike thought about the producers that had decided to stay with the agency after Steve's departure. Jim was a well-known and well-liked leader in the community. He had joined Mike when the agency was in its infancy. Jennifer was a promising young producer that he was considering for promotion. He was glad they had stayed and hoped they would remain with his agency. Nevertheless, with his new understanding of the importance of employment agreements, Mike requested that both Jim and Jennifer sign employment agreements which included non-competition clauses prohibiting all competition in the city in which the agency was located for a period of three years following termination.

In the agreements with Jim and Jennifer, Mike has limited the scope of non-competition to only the city in which his agency is located. By limiting the geography of the agreement, Jim and Jennifer still have a reasonable opportunity to gain employment in the event of termination. Mike has done well to include this limitation. Furthermore, Mike has limited the amount of time during which Jim and Jennifer may not directly compete with the agency to a period of three years. As a typical time frame is two to five years, three years appears reasonable. Mike has further enhanced the enforceability of the non-competition agreements with Jim and Jennifer.

One thing that Mike has not addressed in the agreements with Jim and Jennifer is their consideration, or financial incentive, to enter into a non-competition agreement. If Jennifer is offered a promotion or pay raise at the same time that the non-competition agreement is signed, the increased pay and responsibility may be deemed consideration and enhance the enforceability of the agreement. However, unless Mike compensates Jim in some way, the agreement with Jim may not be viewed as favorably.

More is Better

While it may appear that employment agreements are necessary only for key producers, it would be good to remember that all employees have access to strategic client information and proprietary agency records which should be protected.

Enforcement of employment contracts may vary depending upon the laws of individual states. However, strong employment agreements are much more than a legally defensible contract. They protect an insurance agency by clarifying expectations between the agency and it's employees while balancing the rights of the company with the rights of the employee. By developing and implementing strong employment agreements an agency can go a long way toward protecting the most valuable component of business, its relationships.

The author

Christel L. Sarchet is a Vice President of Mystic Capital Advisors Group, LLC, a national mergers and acquisitions consulting firm, which focuses exclusively on the insurance industry.