You Can't Sell What You Don't Own

by Lorna L. Pankratz, CPCU, CPA

As an agency owner, you and your partners own 100 percent of the stock in your agency. You've grown from a small mom-and-pop agency that was established years ago to a thriving shop with multiple producers.

Then one day, you receive a call from an external buyer who has the deal of a lifetime to purchase your business. You begin questioning your perpetuation plan. Retirement is on your horizon and this is a way to get your chips off the table, work for a few more years, and then enjoy life.

It's your decision. As a stockholder you are in the position to call the shots, right? Not necessarily. The actual ability to sell your business lies in the employment contracts that are in place in the agency. If you don't have them, then you don't have control. And even if you have them, be very cognizant of the control that key non-owner producers have which may impact the sale of the business.

Employment Agreements

When it comes to employment agreements, if you don't have them, you don't own your book of business. Too many owners

overlook the formality of employment agreements. They mislead themselves into saying, "My producers don't have non-compete agreements, but don't worry, they can't go anywhere!" or "I have a great relationship with my producers; they will go along with whatever I decide!"

Too many sales have been stopped when buyers find out that producers without employment agreements are not going to participate in the sale. Furthermore, buyers often require as a condition of close that all producers sign their employment agreements. Nothing wakes owners up quicker than trying to entice their producers to sign an employment agreement with another agency.

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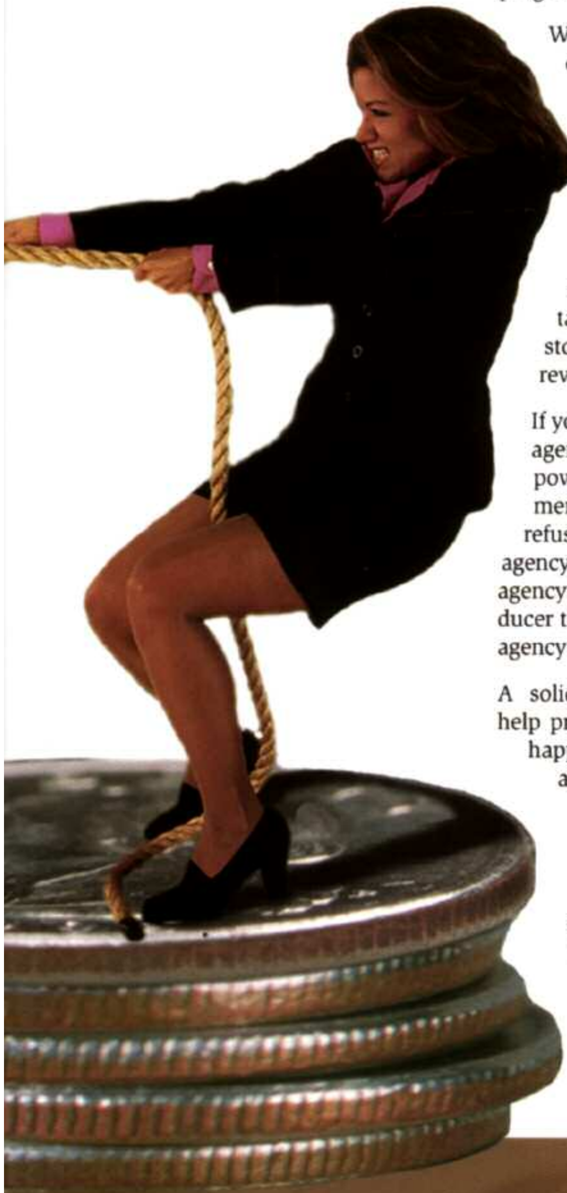
Non-owner producers are not the only ones to worry about. Minority owner producers without employment agreements are equally as dangerous in stopping or altering sales.



Whether it be the scenario above, or a different scenario in which the death or disability of a principal forces a sale of the agency, without underlying agreements signed by the producers, they have all the power. Producers may walk away with their book of business and leave you, or your estate, holding 100 percent of the stock in an agency with little or no revenues.

If you are thinking about selling your agency, the producers have all the power. In the absence of employment agreements, producers may refuse to go along with the sale of the agency and leave. This reduces your agency's value and provides the producer the chance to own his or her own agency…and it's yours.

A solid employment agreement will help prevent the above scenarios from happening while adding value to the agency. The agreements should include clauses dictating ownership of the book of business, non-compete, non-solicitation, and non-piracy provisions. The agreement should also define the length of time the agreement will be in effect and the geographic range.

Typically, the non-compete, non-solicitation and non-piracy provisions are for a two-year period within a geographic range that is reasonable. For instance, in large urban areas the geographic range may be within a 20-mile radius of the city, while in a rural community the reasonable distance may be much greater (100 miles). Bottom line, the agreement should allow for the individual to make a living and should not be unreasonable, or it may be declared unenforceable.

In order to make the agreement more effective, the agency should offer employees some type of consideration for signing the document. New employees of the agency would not require this consideration, as employment is a means of consideration. Each state maintains different employment law standards on enforceability of agreements and an employment lawyer should be retained to draft or review the agency's employment agreements to ensure they would be upheld in court.

The most solid of agreements have a clause that pays producers a nominal amount of money as their book renews for the non-compete time period. For example, 5 percent of commissions on the book of business will be paid to a producer for a period of 24 months as consideration for non-competition and non-solicitation.

Many agency principals question whether or not they should be required to sign an employment agreement. The answer, quite simply, is that every employee should sign the agreement.

The agreement should also be similar for all employees in order to enhance its

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durability should it be challenged in court. You might not think that CSRs should sign an employment agreement; after all, they do not have a book of business. CSRs are often the front-line for calls, and the person many clients consider their primary contact on a day-to-day basis. What CSRs have is a relationship with clients—and isn't that the underlying factor in the insurance business? The non-solicitation clause will prevent CSRs from taking your clients with them should they ever leave.

And don't forget that the most important aspect of an employment agreement is the signature! Make sure that the document is signed. Too often the due diligence process will turn up an unsigned employment agreement filed neatly away in the top producer's file. An unsigned document is of no value.

When purchasing the *assets* of an agency that has employment agreements, you are not buying the agreements. Employment agreements must be signed with the acquiring agency upon closing, and re-hiring of employees should be contingent upon their execution of the acquirer's agreement.

In the rare occurrence that the buyer is purchasing the stock of the agency, the agreements will remain in effect and transfer to the new buyer with the stock. The buyer should review these agreements and know what they are purchasing ancillary to the expirations.

Another thing to consider when buying an agency is whether to retain non-competition agreements with the former principals, whether they will be joining your agency as an employee or insisting that they are retiring. If you do not retain such agreements, nothing prevents these former owners from setting up a competing agency across the street and making the buyer's investment worthless.

One concession that an owner can make to producers is to provide economic vesting of their book of business. Economic vesting provides a benefit to the producer when leaving the agency if certain triggers have been met. These triggers can be length of service or size of book. The benefit provided is a percentage of commissions for a payout price determined by management.

Concentration of Business with a Non-Owner Producer

Even ironclad employment contracts do not always mean you control the sale of your business. It is not uncommon for non-owner producers with large books of business to prevent, alter, or force a deal to happen.

If a significant amount of business is controlled by non-owner producers, you should always discuss a sale possibility ahead of time with them. They may have a strong desire to (1) be the buyer, (2) buy their own book, (3) influence the prospective buyer pool, or (4) prevent any sales.

We have been involved in numerous transaction negotiations that were altered or killed by non-owner producers. They should always be involved in the process. Any due diligence should include interviewing them to see if they are willing participants in a sale or potential hostile combatants. A defecting producer can also influence the mindset of the other producers and other employees which could also kill a deal.

Do not start down the sale process without thoroughly understanding your internal risks. We have seen owners move forward with a sale only to find out that their key employees will not participate. And when a deal gets killed, the owner is left with an employee base that does not trust him. Such a rift could take years to repair.

Be honest with the key players in your agency and with yourself. Just because you own your business, it does not mean you control the ability to freely sell it. Make sure you have solid employment agreements with all employees, including owners. If you have significant producers on staff, always try to discuss the possibility of a sale well in advance to seek their opinion. Try to assess if they will be willing participants or hostile combatants.

Do not start down the sale process without thoroughly understanding your internal risks.

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