



Exit Planning Information & Education For America's Business Owners

The Exit Planning Review™ is an opt-in, bi-monthly newsletter published by Business Enterprise Institute, Inc.

This issue is provided to you by your JD Ford & Company professional, [Joseph Durnford](#).

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Key Employees and Covenants Not To Compete

Part One: The Problem

"My key employee really is key to my company's success, but I can't (or won't) ask her to sign a covenant not to compete. Besides, I've heard that covenants not to compete aren't enforceable."

This dilemma is quite common in the closely held businesses. If, for a moment, you accept a basic tenet of Exit Planning--that the successful exit planning path is paved by a good management team--then you must also accept that losing management team members as your exit approaches can be fatal.

The damage to an owner's exit plan and to the business of losing key people is magnified when employees leave and take other employees customers, trade secrets, and long-term vendor relationships. The focus of this newsletter is how the departure of key employees for any reason can harm your company and consequently your own exit. In the next issue of this newsletter, we'll tackle the solution to this thorny problem.

The most common tool owners use to prevent a departed employee from harming the business is to put in place an enforceable covenant not to compete. There are two immediate and significant hurdles that make this easier said than done.

First, covenants not to compete restrain a person from freely engaging in his or her trade or occupation. For that reason, they can cause harm to that individual and to his family. Restraining an individual's actions strikes at the heart of our American concept of liberty and freedom of action. Restraints or restrictions upon one's ability to earn a living are therefore limited and, in many cases, prohibited.

Secondly, even when permitted (as described in Part 2 of this article) many employers are reluctant to present their key employees with a written covenant not to compete for fear that the key employee will become angry and do exactly what the owner does not want--leave the company! Adding insult to injury is the fact that covenants not to compete are unenforceable when the employee is not given fair consideration in return for signing the covenant.

I recently met with two co-owners of business to discuss a possible sale of their company. When I learned that they had owned the business for only five years, I was shocked. Their company had over 125 employees, \$10 million of revenue, and made almost \$2 million a year in profits.

"How in the world did you create such a vibrant business in such a short time?" I asked.

"Well, we both worked at the same company and decided we could do a better job if we had our own business. So we left and took 30 of the key employees and all of the important customers. Within a year and a half, we had over 50 employees and were making good money. We were given an even bigger boost when our former employer shut its door and the rest of the employees and business came our way."

"Didn't you have covenants not to compete?" I asked.

"Ironically, it was when we were asked to sign employment agreements (that included covenants not to compete) that forced us to begin thinking about how to instead *start* competing!"

Could this happen to your company? Given the hurdles that need to be overcome, is it possible to create enforceable covenants not to compete in a manner that is not offensive to your key employees who will be asked to sign them? What can you do?

In two weeks, you'll receive the second part of this article in your e-mail box. If you can't stand the suspense, contact the person who sends you this newsletter for information on how you can solve this problem.

*Subsequent issues of **The Exit Planning Review™** discuss all aspects of Exit Planning. The provider of this Newsletter (durnford@jdford.com) offers you unbiased information about what you most need to know - **How To Run Your Business So You Can Leave It In Style™**.*

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