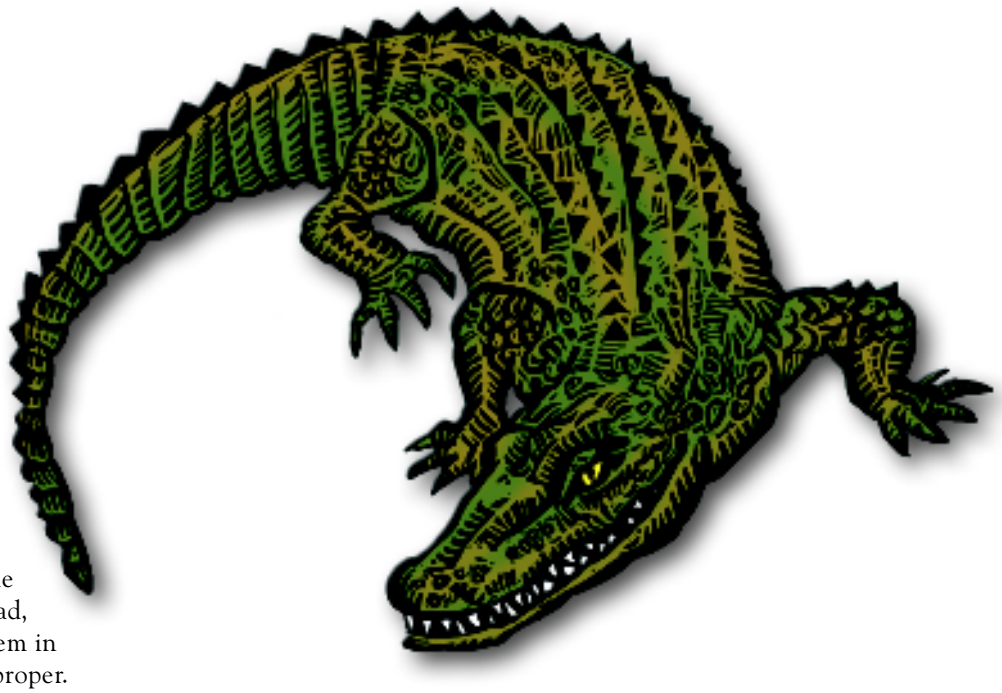
Non-Compete Clauses

by MITCHELL A. KRAMER



We have all heard urban myths — crocodiles attacking people in sewers; Jimmy Hoffa buried under Giants' Stadium in New Jersey. They sound real, but they are not. The distribution industry has such an urban myth. The myth is that non-compete clauses in manufacturers' representatives' contracts can be ignored because they do not mean anything. That statement is false. In almost every state, a tightly drawn non-competition agreement will be enforced by the courts. Even if the non-compete requirements are overly broad, the courts in many states will narrow them in order to enforce what the court feels is proper.

If you are sued to enforce a non-competition agreement, even if you win (and it is quite likely that if the facts are against you, you will lose) your legal fees will be very high. Even worse, if you have signed a broad agreement not to compete after you cease representing the manufacturer, it is probable that other manufacturers that have even one overlapping product will not engage your company. Such principals will be more concerned with defending a claim for tortious interference with contract than they will be anxious to name you as their representative.

Non-competition provisions in representative contracts come in many forms. Does the non-compete provision end when your representation ends? If so, as long as you are only prohibited from carrying products that compete with what you are selling in only the geographic area in which you are selling them, such restriction is usually acceptable. Except in unusual cases, an agent is comfortable agreeing not to compete with products it sells for its principal in the territory in which it represents the principal.

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Post-Termination Agreements

Post-termination non-competition agreements are another matter. Almost any time one loses a line and begins representing a competing line, it will lose a certain percentage of its business. If the representative is out of the market for any length of time, it is much more difficult to hold onto customers.

Our clients have generally been successful in eliminating post-termination non-competition agreements. Manufacturers sometimes will insist on retaining post-termination non-competition agreements when its representative is terminated for cause.

But before the contract is signed, most manufacturers will agree to not have non-compete provisions, if the contract is terminated by the principal or not renewed. Certain states, such as Pennsylvania, have decided that when an employee is fired, a post-termination non-competition provision will not be enforced. The reason for this rule is that if the employee is not worth keeping, the employer does not need protection from him. It is likely that the same rule would apply to sales agents. It should be emphasized, however, that most states have not adopted such a rule.

California is the only state, as of now, that has a law that prohibits post-termination non-competition agreements in virtually every case (there are certain exceptions, such as where the company is sold and the sellers are prohibited from competing with it).

The treatment of non-competition clauses varies widely from state to state. Some states have laws governing limitations on competition. All states have court decisions dealing with such issues, and the decisions vary widely from state to state, and often from court to court within a state. Most non-competition issues that get to court result from the filing of an injunction action by the principal. An injunction is a request to the court to stop certain activities or to force one to do something. These are always cases in equity, which means that they are always tried by a judge without a jury.

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Preliminary injunctions (a request to stop something that is imminent) are often tried by the court within days or weeks after the lawsuit is filed. There have even been cases where a party has gone into court without the other party being present, or even given notice, and gotten a temporary restraining order, that is, an order stopping a party from doing something. Such an order generally is only good for 10 days, and within that 10-day period, the court will have a hearing on a preliminary injunction. Even though there is a procedure for a full trial on a permanent injunction, in non-competition cases the decision on the preliminary injunction is usually the end of the case. By the time the case would come to trial, the time for the non-compete to run is probably over.

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You need a sharp eye to read a non-competition clause in a contract and figure out what it is that you are being asked to sign. Such contracts deal with products, territory and length of time.

On products, are you being asked to not compete with the products that you are selling, or with all products manufactured by the company that you are representing? On territory, are you being asked to refrain from competing in the territory in which you represent the manufacturer, or are you being asked to refrain from competing in a broader area? Are you being asked not to sell to customers to whom you sold for the principal, or is the non-compete restriction something else? On the issue of time, are you being asked to refrain from competition while you represent a manufacturer and also after you represent the manufacturer and, if so, for how long after you stop representing the manufacturer?

Trade Secrets

The trade secrets provisions of representative contracts play into the non-competition area, but are usually somewhat less important. You should be aware, however, that sometimes a non-competition provision can be sneaked into a trade secrets provision.

If a manufacturer comes to you with a substantial bank of business, it may not be unreasonable, if you resign the line, to require you not to compete for a

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few months so that the manufacturer can fill your company's slot and have sufficient time to hold onto the business. It is quite another thing if a manufacturer, with no business, engages you to represent it, reaps the benefits of your successful market penetration, terminates you, and then has the right to keep you from competing.

As with many areas of your business, considering how to deal with a contract that is offered to you, which includes restrictive covenants, requires business judgment, negotiation and probably legal advice.

Our law firm is now seeing more and more contracts offered with one- and two-year post-termination non-competes. We are also beginning to see the effect of such contracts on companies that have recently been terminated by manufacturers that have gone direct or have sold out to larger companies.

The whole area of non-competition with principals is one fraught with danger for the future success of your business. It should be treated as such. ❐