

# Safeguarding Your New Agency from Seller Competition

BY TABITHA HUGHES

**A**s a lender working with Allstate agents for over 10 years, I've seen a recent trend of wherein fewer sellers are opting to retire following the sale of their agencies. Some are making complete career changes or relocating, but many are continuing on in the insurance business in the same market area. Considering this new development, one of the most important things agency buyers can do for themselves is procure an adequate restrictive covenant in conjunction with their agency purchase. Restrictive covenants can help protect agency buyers from post-acquisition interference by their sellers and the irreversible damage it can cause to their new agency.

## Worst Case Scenario

Steve purchased an Allstate agency from Greg, and paid him \$400,000 at closing. Steve didn't hire an attorney to draft a formal purchase agreement -- they simply signed Allstate's required transfer documents. Greg didn't discuss his future plans in detail with Steve; he only mentioned he was going to pursue another business venture. A few months after closing, Steve discovers that the other venture is an independent agency--located just a few miles away from his newly acquired agency. Greg has a great new Yellow Pages ad, a website, and a nicely appointed office he purchased with the funds from his agency sale to Steve. Greg is also contacting his former customers, and Steve begins to lose business. Steve is naturally very angry, but he has no legal recourse because he has no written agreement with Greg stipulating he cannot compete with him. Steve is now left to repair the damage done to the agency, as well as repay the \$400,000 loan he secured to purchase it.

## Due Diligence

Of course, most agency buyers don't suffer bad experiences like Steve, but the potential damage a seller can do to a new buyer's agency poses a serious risk, and buyers have a responsibility to conduct their own due diligence prior to completing an agency purchase. Buyers should speak with their sellers early in the negotiation process to determine their plans after the agency transfer. They should also hire an attorney familiar with Allstate agency purchases (or at the very least small business acquisition) who can draft an appropriate, enforceable restrictive covenant. With an adequate restrictive covenant, a buyer can sue for damages and recoup some of their lost investment. Furthermore, sellers are less likely to violate a written contract.

## Allstate is Not a Party to the Purchase Agreement

Sometimes sellers are hesitant to sign a strong restrictive covenant because their R3001 Agreement with Allstate only stipulates that they not compete for one year and within one mile of their agency location. While this is true, it is important to differentiate that they are not selling their agency back to Allstate--they are selling it to a buyer, presumably in good faith. Buyers should remind sellers that while Allstate approves the transfer, the company is not a party to their purchase agreement; that agreement is strictly between the buyer and seller. Furthermore, the buyer is paying the seller a price for the agency that is higher than the TPP value Allstate would give them. In exchange for the higher price, the buyer is entitled to, and should expect, protection from competition by the seller. If after discussing these points, the seller continues to resist entering into a strong restrictive covenant, the buyer should investigate the seller's motivation behind this

reluctance. As a general rule, sellers who have no intention of interfering with the buyer's agency have no objection to signing a strong restrictive covenant.

### **Enforceability of Restrictive Covenants**

Often, a seller's resistance to signing a restrictive covenant, as well as a buyer's resistance to pushing the issue, is due to a preconceived notion that they are unenforceable. Contrary to popular belief, restrictive covenants are generally enforceable when the purchase of a business is involved. Restrictions against competition and solicitation that would normally not be enforceable in an employer/employee situation are often allowable when those restrictions are bought and paid for as part of a business purchase. In an agency acquisition, the restrictive covenant is considered an intangible asset and can be given a value. It is necessary for the ongoing success of the business, as a breach of the covenant by the seller could cause irreparable damage to the buyer's agency. Thus, agency buyers can justify asking for a strong restrictive covenant in order to protect themselves and the health of their business from interference by the seller.

### **The Traditional Restrictive Covenant**

Most restrictive covenants include a Covenant to Not Compete and a Covenant to not Solicit. *Non-Competition* covenants should address:

- What the seller and/or its representatives are specifically prohibited from doing - such as owning another agency, being employed by another agency, or being in any way involved with a business similar to the one that is being sold.
- The time period over which the restrictions will be in place.
- The geographic area for which the restrictions will be in place.

*Non-Solicitation* covenants should prohibit the seller or its representatives from:

- Direct or indirect solicitation of the customers transferred to the buyer.
- Direct or indirect solicitation of former employees of the seller that are being retained by the buyer.
- Direct or indirect solicitation of any key referral sources.
- Damages the buyer can recover in the event of a breach by the seller should also be outlined.

### **The Opportunity of a Lifetime**

Not all agency purchases are the same, and not all restrictive covenants should be the same either. Every buyer should seek the counsel of an attorney when purchasing an agency. An attorney can give advice and draft an agreement that is appropriate for each unique agency purchase. Buying an agency is a once-in-a-lifetime investment- an important asset that should be protected.



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