

“Non-compete” and “Non-solicitation” agreements at the US subsidiaries of German companies?

Yes or No?

Waldthausen & Associates, Inc. is a Retained Executive Search firm with the focus on recruiting managers that influence a company's result and earnings. The firm focuses on recruiting professional managers for US subsidiaries with parent companies located in central Europe.

As an Executive Recruiter and because of my experience as President/CEO of two subsidiaries of German companies, I get asked many times about pre- and post employment implementation of restrictive covenants and the protection of trade secrets. But in spite of experience as a professional recruiter and business executive, it is difficult to obtain reliable data about the usage and structure of these restrictive covenants. Specific data covering the US-subidiaries of German companies appears to be almost completely unavailable. In order to fill the void and to provide some information, I have looked from time to time at studies, I participated in while a business executive which allowed me to share in the results and to evaluate what my then peers were doing and to evaluate the usage, structure, effectiveness and future deployment of restrictive covenants. For most executives with Profit & Loss responsibility this topic is of particular importance but it also should be of importance for representatives of the German or European parent company, since it may affect them quite directly when changes take place in the top management of their US-subidiary.

What always struck me as particularly interesting is the fact that only around 40% of companies with less than hundred US employees use restrictive covenants. In surveys those companies however state that they are currently in the process of looking into this or that they want to make changes in contracts written for the future.

An employment agreement implementing non-compete clauses and non-solicitation clauses (of both, clients and coworkers) is important to avoid surprises later on. If any of these provisions are missing, nasty blows can follow the departure of an executive. For example, a former employee can legally solicit clients as long as no confidential information is being used. A competing company can be established across the street. A company's most valuable employee can be pouched. A key executive can seek greener pastures with a competitor.

Although companies made clear efforts to introduce restrictive covenants, many are in less good shape than they hope for. Almost three quarters of users indicate that they have no specific geographic restriction in their agreements. Only a fifth of the respondents of a recent survey limit their restrictive covenants to specific competitors. On the upside is the fact that almost all companies appear to use very reasonable time limits. Nearly 70% of the respondents stipulate terms of one year or less.

US courts look more favorably upon non-compete agreements if the employee received something (US \$) in exchange for agreeing to a restrictive covenant. This is particularly important if a current (not future!) employee is asked to sign a restrictive covenant. Only a handful of respondents indicated that they offered employees some form of compensation during liberation of the agreement. Employees who believe that a signed non-compete agreement constitutes only a little more than “paper-tiger” might be in for a surprise. The users of restrictive covenants place a high value in them as an effective tool to protect their competitive interests. Almost 60% stated that they will enforce a non-compete or non-solicitation agreement if they become aware of a violation. And more than half indicate that they agree or even strongly agree that a court will uphold their agreements.

However, some of the respondents who are confident in the enforceability of their restrictive covenants might be unpleasantly surprised if a judge would ever review specific agreements. The returns indicated that many courts might decide that the lack of geographic restrictions, the lack of compensation for signing such clauses, fuzzily defined competitors and broad industry coverage might not fit their definition of reasonably and fair.

And this is unnecessary. After all, fair and equitable agreements are possible and within reach for every firm of every size and also for employees. It also is important to consider that the immediate value of a restrictive covenant is to deter employees to even consider joining a competitor. It is therefore in conclusion our recommendation that attorneys are involved when drafting employment contracts for top management and key executives and that the issue of non-solicitation and non-compete clauses are discussed with them.

Some survey results:

- Only half of all companies use non-compete agreements.
- Only 14% of all surveyed companies with less than 100 employees use non-solicitation agreements.
- Only 9% of all key executive employment agreements bar employees to recruit colleagues and peers.
- Only 8% of surveyed employment contracts name specific competitors (non-compete) and avoid broad industry coverage.
- Only very few companies provide compensation for designing of non-compete agreements/clauses.

Will your employment contracts withstand an initial legal screening process?

- Are geographic restrictions inline with your business and the responsibilities of the employee?
- Is the duration of the agreement inline with industry standards or the real needs of the company?
- Does it name specific competitors and employee can not join? Or is it industry wide?
- Does it ask that an employee not recruit former colleagues and peers?
- If employees signed the agreement after employment started, did they receive a tangible benefit?
- Are existing agreements only selectively enforced?

Kurt G. Waldthausen
Waldthausen & Associates, Inc.
KWaldthausen@waldthauseninc.com