An Alternative to Noncompetes: Forfeiture for Competition Agreements

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Enforcing covenants not to compete against former employees or sellers of businesses has always been somewhat problematic. In particular, non-compete agreements are governed by state laws that differ considerably state by state depending on the public policy of the state. For instance, California is well known for its public policy against non-competes while Florida more strictly enforces them. The lack of uniformity in non-compete laws is most troubling for companies that operate throughout numerous state jurisdictions. Also, as a practical matter, many judges are simply reluctant to enter orders prohibiting people from working in their chosen fields. Litigating non-compete disputes are routinely expensive and the results uncertain.

As a consequence, employers and purchasers of businesses are more frequently turning to “Forfeiture for Competition Agreements.” Such agreements basically provide that if the employee or seller of a business competes, then such competing party forfeits certain benefits such as severance pay, stock incentives, deferred payments and earn outs. A major advantage of this type of arrangement is that it can be enforced by an employer or a purchaser of a business without filing a lawsuit and obtaining a court order. The benefits are simply withheld requiring the competing party to initiate a lawsuit for damages if there is a disagreement. Equally important, the court is never faced with making the hard decision of whether or not to enter an order prohibiting a person from certain employment or a scope of business. Instead, the court will consider only whether the competing party must forfeit the monetary benefits that were previously agreed to between the parties. The courts, in general, are significantly more likely to uphold a forfeiture of agreed upon monetary benefits than to enter an order enjoining a person from employment or a scope of business.

As “Forfeiture for Competition Agreements” become more common, there are precautions to consider. Most apparent, such agreements create a ceiling on the recovery against the competing party. A scenario can develop where the agreed upon forfeiture amount turns out to be too small compared to the potential reward to the competing party – thus creating an incentive to compete. Also, from the prospective of an employer or purchaser of a business, the actual losses incurred from the competition may end up far exceeding the agreed upon forfeiture amount. As a result, “Forfeiture for Competition Agreements” are best used when the losses from the competition can be reasonably quantified at the time such agreements are entered. Another precaution is that the
Forfeiture of ERISA qualified benefits, which typically vest, may not be permitted under ERISA. Before including a forfeiture provision relating to an ERISA qualified benefit plan, one should first seek professional advice regarding the plan.

In sum, “Forfeiture for Competition Agreements” can be a more effective and efficient method to assure compliance with non-compete restrictions when used in the proper circumstances.

Attorney Hank Jackson of Shutts & Bowen LLP is Board Certified in Business Litigation by the Florida Bar. He represents individual and companies in a variety of business disputes, including non-compete claims, trade secret misappropriation claims, and business control and dissolution claims within closely held businesses. Contact him at hjackson@shutts.com.

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