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Fearing Turncoats, Owners Protect Secret Sauce

By SARAH E. NEEDLEMAN



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Two years ago, Arthur Zilberman learned a painful lesson when an employee quit his small computer-repair company and started a rival firm around the corner. He says the defector copied his business model ? including strategies that took years to develop ? and lured away several big clients.

"When he left, they went with him," says Mr. Zilberman, owner of LaptopMD Inc. in New York, which launched in 2005 and today has six employees. He estimates he's losing up to 10 repair jobs a day to his former employee-turned competitor.



LaptopMD Inc.

Arthur Zilberman now includes a noncompete in all employee contracts.

For business owners just starting out, preparing noncompete agreements for new recruits may seem like a low priority, superfluous or even unfit for an entrepreneurial venture. But human-resources and legal experts say such an accord ? whether it's actually enforceable by law or not ? could help protect against losses incurred by turncoat employees, though there are exceptions.

"It's a poker game you're entering," says David Lewis, president of OperationsInc LLC, a human-resources consulting firm in Stamford, Conn. "You want to make it seem that as an employer, you are holding the cards and that you are in control."

Mr. Lewis says that by virtue of having a noncompete, employees are less likely to breach it for fear of possibly facing legal

action. "They have to take the gamble that you're not going to take steps like an injunction before a court has even gone ahead and ruled for or against you," he says.

Noncompetes can also be helpful for business owners looking to one day sell their firms, adds Christopher P. Stief, a partner and chair of the employee-defection and trade-secrets practice at Fisher & Phillips LLP, a national law firm. "The buyer is going to want to know if you've had your key people locked up," he says. "Part of what they may be buying is the relationships your people have with your clients. They need to know those people won't leave and take that book of business with them."

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To be sure, there are also potential downsides to noncompetes. Mr. Stief says they may be perceived as a turn-off for some job hunters looking to eschew the kind of stringent employment policies commonly associated with large organizations. "It can be a point of contention when you can't offer an involved benefits plan or a big salary," he says.

Laurie Pitman, owner of Golden Gate Helicopters LLC, a transport firm with two California locations, says she would almost never require a new recruit to sign a noncompete. "It's anti-innovative," she says. "You don't want to scare people by saying you won't be able to share your ideas."

But Robyn Barrett, owner of Factors Southwest LLC, a small financial-services firm in Phoenix, says companies that provide a highly specialized service or cater to a niche group of customers might need more protection than others. In her case, "it took me a long time to develop my own contacts, policies and procedures and an employee could easily take that and literally build the same company I have," says Ms. Barrett, who has noncompetes in place. "They basically would have my company manual."

Business owners should note that not all states recognize noncompetes and trying to enforce one in a state that doesn't could backfire on a small company, warns Mark S. Adams, a partner with law firm Jeffer, Mangels, Butler & Marmaro LLP in Costa Mesa, Calif. "You could be hit by the defendant in a countersuit and be liable for damages, including punitive damages."

Even in states that do recognize noncompetes, such an agreement could fall flat if it's deemed unreasonable by a court of law, says George L. Lenard, a managing partner and employment attorney for law firm Harris Dowell Fisher & Harris L.C. in Chesterfield, Mo.

"You can't expect to enforce a noncompete against someone who has no influence over customers or no confidential business knowledge," he says.

A judge is also likely to take into consideration how much time and distance a noncompete outlines, adds Mr. Stief. These typically depend on what industry a firm is in and its target customer demographic. For example, an insurance agent might be expected to sign a noncompete for a certain territory lasting at least two years or more since consumers typically renew insurance policies only once a year.

"The courts are going to look closely at how much protection you need, if any," says Mr. Stief.

Mr. Zilberman, the computer-repair business owner, says he now includes a noncompete in all employee contracts. "Everybody who starts has to sign it," he says. "Because my employees know they have this noncompete, they're still here."

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About Sarah E. Needleman

Sarah E. Needleman has been a reporter for Dow Jones since 2001 covering job hunting, executive recruitment and other career-related topics. She writes Small-Business Boss, a weekly column about the challenges that first-time entrepreneurs face in managing employees.

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