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BUSINESS NOTES
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NONCOMPETITION AGREEMENTS – THE SAGA CONTINUES

We have previously written about the *SWAT 24* case handed down by the Louisiana Supreme Court in June of 2001, wherein the Court interpreted La. R.S. 23:921 to allow an employer to prevent a former employee from opening his own competing business, but not from becoming an employee of a competing business he does not own. *SWAT 24 Shreveport Bossier, Inc. v. Bond*, 00-1695 (La. 6/29/01), 808 So.2d 294. We have also reported on Act No. 428, passed by the Legislature in 2003. Act No. 428 was an attempt to legislatively overrule *SWAT 24* by amending La. R.S. 23:921 to provide that a person may be deemed to be carrying on or engaging in a competing business "regardless of whether or not that person is an owner or equity interest holder of that competing business."

The Louisiana 3rd Circuit Court of Appeal recently considered whether Act No. 428 should be given retroactive effect. *Sola Communications, Inc. v. Bailey*, 03-0905 (La. App. 3 Cir. 12/10/03), _____ So.2d _______.

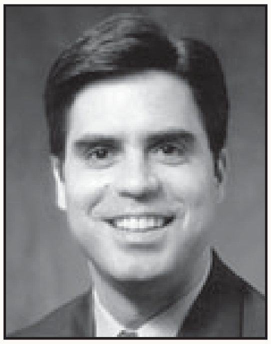
Tony Bailey was a part of a limited liability company that acquired Sola Communications. In connection with the acquisition, Bailey received an 8 percent equity interest in Sola. He also became Sola's vice president of operations and entered into a noncompetition agreement in which he agreed that, if he was terminated, he would not work for a competing business for the following two years. Sola later terminated Bailey's employment and sought to enforce the noncompetition agreement when Bailey was hired by a competing business.

Bailey defended the suit on the basis that the agreement was invalid under La. R.S. 23:921, which prohibits contracts restraining persons from engaging in a lawful profession, trade or business. The law includes an exception that allows limited contracts prohibiting people from "carrying on or engaging in" a business similar to that of their former employer. Since Bailey was not an owner of the competing business for whom he went to work and Act No. 428 had not yet been enacted at the time in question, Bailey argued that *SWAT 24* applied and therefore his noncompetition agreement did not extend to employers in which he was not an owner.

First, Sola argued that SWAT 24 was distinguishable because Bailey was not merely an employee of Sola, but also one of its shareholders. Therefore it argued, the public policy concerns underlying La. R.S. 23:921, namely, the protection of employees who are at an uneven bargaining position with their employer, did not apply to Bailey. The court rejected this argument, finding that, under *SWAT 24*, the nature of Bailey's subsequent employment with the competing business was determinative, and that the circumstances surrounding his initial employment at Sola had no bearing on the validity of the contract.

Sola next contended that Act No. 428 should be applied to uphold the agreement. The 3rd Circuit applied the rule contained in Article 6 of the Civil Code: that, in the absence of a legislative directive, interpretive laws apply retroactively, but substantive laws apply prospectively only. Although it acknowledged that La. R.S. 23:921 had been interpreted differently by the courts of appeal prior to the Supreme Court's pronouncement in *SWAT 24*, and notwithstanding the new law's directive concerning the meaning of the phrase "carrying on or engaging in," the court concluded that Act No. 428 was substantive because it established a new rule. Therefore, retroactive application was not appropriate in this case.

The moral of the *Bailey* case? Employers who had noncompetition agreements executed before the effective date of Act No. 428 should seriously consider whether they should have new agreements executed.



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EXIT STRATEGIES AND CONTINGENCY PLANNING

"Bailout, bailout, bailout!" A simple word repeated three times has great significance to airplane crews. Said but once, the word could have many meanings, but when repeated three times, all members of the aircrew have a clear understanding that if they delay, they will be looking out their window at their colleagues' parachutes. The thrice repeated word is part of a simple contingency plan that can be executed at any time upon the happening of an unexpected event in order to avert disaster.

When multiple people are forming a new business endeavor, it is likewise important to not only plan for the good times, but also for the bad. Issues such as a partner's death or incapacitation, a partner's divorce (when his interest in the business is community property), retirement, and simple disagreements between partners, are issues which are much easier to address when in the "honeymoon" period of a new business, rather than after negative events have occurred. Typical provisions used to address these issues include a forced buyout of a deceased partner's interest in the business by the business entity, or the remaining partners, which purchase price can be financed by life insurance held by the business. Such a forced sale provides certainty to the partners as to whom they will be doing business with, while protecting the deceased partner's family financially. Valuation of a partner's interest in the entity can be agreed to annually, or a formula can be determined at business inception, that would rely only upon a calculation by the entity's accountant to determine the buy-out price.

In situations where the ownership of a business will be split equally between two people, or two segragable groups of people, it is important to plan early for disagreements which may arise, and to provide mechanisms for resolution and ultimately a split of the business if problems are irreconcilable. Many agreements provide for formal mediation or arbitration in the event an internal dispute erupts. Such dispute resolution procedures are advisable, but a provision addressing the final division of the business should also be addressed. A buy/sell agreement, sometimes called a "push/pull" provision, which is agreed to by the partners at an entity's inception, will allow any partner (the "Initiator") to set a price at which he may offer to purchase another partner's interest at a specified price, or once the offer is made, allow the other partner to instead purchase the Initiators' interest at the same price. This provision encourages all partners of the venture to work together to solve their problems, but allows for final resolution of disputes should irreconcilable differences arise.

In short, it is fine to hope for the best with a new business, but you should also plan for your "bailout" from the business should the need arise.

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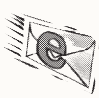

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