

## H.1 NON-COMPETE AGREEMENTS

- Good morning for the record Chris D'Elia, President, VT Bankers Association
- Thank you for the opportunity to testify
- With any bill of interest to the banking industry, it is my job to understand the problem we are trying to solve, how big a problem do we have in VT
- With little to no data, so far, I have heard a couple of antidotal stories
- Regardless of the problem we are trying to fix, let's make sure our solutions address that problem while limiting unintended consequences
- We do not support the bill as introduced because non-competes play an important role in protecting the parties involved
- Companies have a legitimate business interest in protecting their confidential and proprietary information and limiting, in some ways (in geography or duration) their employees' ability to take that information and use it at a market competitor.
- Non-compete restrictions are nearly always addressed before an individual accepts employment with the employer requiring the non-compete provision. Employees go into these situations with their eyes open and take the job knowing that there are some limitations on the back end.
- Now let me be clear non-competes for a teller or as Representative O'Sullivan said to me the pizza guy are certainly not appropriate
- But they are in other cases, so let me try to give you a few examples
- Non-competes for highly compensated employees, typically CEOs and senior managers
- They are often contained in executive severance agreements and change in control agreements

- CIC's are provided to senior managers to protect them in the event their bank is sold and their position, responsibilities, and/or pay levels are materially changed.
- Often these are a multiple of annual salary.
- In exchange for this protection, the individual agrees not to take a job with a competitor for a specified period of time, or within a certain mile radius, which is the non-compete part of the agreement.
- Not all banks offer them, but many publicly traded banks do.
- They are really retention tools. If a bank is selling itself, senior executives need to be motivated to complete the transaction.
- On the other side, the buyer needs comfort that the critical and strategic information they are buying and may be known by the departing executive will not be shared with a competitor
- If a senior executive willingly signs an agreement and the CIC provision is at some point triggered resulting in meaningful compensation, that should not be ruled illegal
- Non-competes involving the development of a book of business
- Non-compete agreements are important when companies spend a great deal of resources to compensate and train their employees along with developing the necessary infrastructure to help them attract, retain and service clients.
- That book of business is owned by the company and, like other assets, the company needs to be able to protect it.
- Usually individuals become clients because of the company's reputation, stability and branding.
- Often this is the result of decades of work by many current and former employees, as well as considerable marketing costs.
- Many of the clients a company may have are not solely attributable to the client facing employee's efforts. There are teams of individuals at the company working in the background to support clients and the client facing employee.
- For example, employees in the trust or wealth management department of a bank

- Many client facing employees do not process the receipt of interest and dividends, investment transactions, bill payments or remittances. Nor do they manage portfolio investments, generate statements or provide tax information. All of these functions are performed by teams of individuals in the back office. Without these staff members, it would be impossible for a frontline employee to manage nearly as many accounts as they otherwise do.
- So, without a non-compete, if they left and took the book of business, all the resources and money spent over the years would be lost
- It doesn't mean a client can't leave on their own, they are certainly free to do that
- But a non-compete will allow a bank to keep departing employees from taking employment with a competitor across the street where they could immediately use their "inside" information about your customers, your pricing, your business practices, your strategy- and give it to your direct competitor who will then use it against you to steal away the customers you paid the employee to attract and retain.
- There are also other compensation structures that may or may not be tied to non-compete agreements which could be the victim of unintended consequences with this bill
- There are forfeiture for competition agreements that offer the ability to limit an employee's post-employment competition through an agreement that states an employee who competes will forfeit a certain benefit, such as a stock incentive, deferred compensation
- Employees who satisfy certain age and years of service criteria are eligible to continue vesting in what are called restricted stock unit ("RSU") awards and other long-term incentive ("LTI") awards after termination, provided that they do not engage in competition.
- These employees have the option of competing or continuing to vest in the plan after termination of employment

- There is concern Vermont courts will likely interpret the non-compete legislation as applying to RSUs/LTI awards unless “forfeiture for competition agreements” are specifically excluded.
- In these circumstances, it would be unreasonable to expect a company to continue to remit payments to individuals who are employed by its competitors.
- Then you can have a nonqualified deferred compensation plan created to provide key frontline employees with the potential to accumulate significant financial compensation after attaining retirement age IF they do not compete with a company or take clients prior to attaining the retirement age.
- Think of it as a company making an agreement with an employee that says “If you don’t compete with us or take our clients, we’ll pay you a bonus after you reach retirement age.” Balances of such accounts can be as much as \$100,000; \$500,000 or even greater amounts.
- It is important to understand that **THIS IS THE COMPANY’S MONEY** that is contributed to this type of nonqualified deferred compensation plan, **NOT** part of the employee’s compensation.
- The employee understands that if the employee leaves the company to work for a competitor and/or takes clients, he or she will forfeit their interest in the nonqualified deferred compensation plan.
- Keep in mind that the **ONLY** reason the company creates this type of nonqualified deferred compensation plan is to reward employees for their loyalty to dissuade them from competing with the company or taking the company’s clients. If legislation were passed to not permit the use of nonqualified deferred compensation plans in this manner, then companies would cease offering this potentially valuable benefit to certain key Vermont employees.
- Again, there is some concern Vermont courts will likely interpret the non-compete legislation as applying to non-qualified deferred compensation plans unless specifically excluded.

- So, given these examples and concerns, where do we go from here
- Consider what other state have done, especially in New England
- Allow non-competes to continue in VT under certain circumstances
- Non-competes help to protect trade secrets; intellectual property; customer relationships and lists; strategic initiatives; proprietary information; technologies; and much more
- Focus on those types of issues
- Absolutely critical, the bill should be revised to exclude employee/client non-solicitation covenants from its scope.
- As currently drafted, it is possible that Vermont courts may interpret this legislation to invalidate certain non-solicitation covenants.
- The bill should be amended to permit non-solicitation and non-compete clauses in nonqualified deferred compensation plans that are solely funded by the company (and not by deductions from employee compensation).
- The bill should be amended to permit forfeiture for competition agreements
- The bill should be revised so that it is limited to employees who are residents of Vermont/employed in Vermont *at the time the non-compete agreement is executed*.
- As currently drafted, this legislation would potentially invalidate non-compete agreements entered into with employees who move to Vermont after executing a non-compete agreement.
- The bill could contain an income threshold and should only apply to non-competition agreements entered into with employees who earn less than the specified threshold.
- The bill should be revised to exclude non-competition agreements entered into in connection with a separation from employment (e.g., severance agreements).
- These are just some examples of how to modify the bill to truly address the problem without unintentionally impacting those who are conducting themselves properly