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Prevent a Non-Compete from Destroying Your Wealth

Portland, Oregon's footwear and apparel industry is in an economic boom. Over the last decade it has seen several prominent brands locate to the Metro Area. Many of these brands are seeing double digit growth and are increasing their footprints in Portland. Much of the boom appears to be driven by the deep creative sports attire talent pool within the City. Recently, numerous published articles have described this rampant growth in Portland. Kati Chitrakorn published an article in The Business of Fashion about Portland being the next Footwear 'Silicon Valley' as the city is home to 800 athletic and outdoor companies. She describes Portland's incredible talent pool as driving brands such as Under Armor, Adidas, Columbia Sportswear, Mizuno and Keen to move to or enlarge their current footprint in Portland. Jeff Manning recently published an article for the Oregonian describing this "frantic expansion" in Portland. He describes the vital importance Portland talent has had for brands which initially started by "poaching Nike talent" and currently has led to large facility expansions for Adidas, Nike and Under Armor enabling further aggressive growth plans in Portland.

This burgeoning economic activity and competition for talent is likely to increase compensation and improve benefits packages for footwear and apparel industry professionals, while much of the nation is still looking for income growth since The Great Recession. We are already seeing signs of the impact of this competition. Nike recently released information on plans to improve its benefit structure introducing the "New Family Care Benefits." Additionally, Pacific Capital Works has observed among clients who are industry professionals of these brands now receiving regular compensation reviews which sometimes are followed by salary increases. The reviews occur more often and are aligning pay and ensuring fair compensation compared to peers and competitors. These reinvigorated reviews, which may have existed previously in structure but lacked execution, clearly appear to be an effort to retain employees in this talent competitive landscape.

However, Portland's Shoe Boom is not without its complications. In an effort to limit the competition for these talented professionals many of these brands are implementing and revitalizing previously existing non-compete clauses. These legal clauses provide the option to an employer to restrict the employee from working with competitors in the industry for a defined period of time, usually a year, by continuing to pay a percentage of the former employee's previous salary. The employer defines "competition" and the competitors, the period of restriction, and can terminate the agreement and the amount of compensation at any time during the period. Legal experts recommend companies enforcing a non-compete clause apply them equally among similarly bound employees to strengthen their defense when challenged. Non-compete clauses are legal in 47 states. In the past it appears these clauses were only enforced with certain professionals and only required to be signed sporadically among the ranks. However, as Portland's talent war escalates among the brands firms have ratcheted up both the enforcement and the number of employees who are required to sign them.

It is well documented in the business literature and even reported by the Treasury Department that non-competes inhibit worker mobility, depress wages, and reduce growth and entrepreneurship. It is also not surprising to note that one of the nation's strongest entrepreneurial communities 'The Silicon Valley' has benefited from California's prohibition on non-compete clauses, which some scholars have indicated contributes to the regions success. Instead California opts for the weaker and perhaps more capitalistic approach, employing the Non-Disclosure Agreement which allows the employee the freedom of movement but doesn't allow them to share trade secrets and practices.   However, some pundits still argue in favor of the non-compete that it allows firms to retain the benefits of worker training and encourages greater workforce investment in their employer. It seems clear in Portland the clauses are being used as a tool to slow and inhibit the transfer of employees and knowledge. I think some of us can sympathize with the enforcement in limited cases, but the fact of the matter is that these legal clauses are being enforced far more widely now among industry employees and creating the potential for financial ruin among these talented professionals.

I don't think many realize one could work for a firm for 20 years; be terminated and then be unable to find employment in their industry for one year because of a non-compete clause. Many professionals also discover that 50% of their prior salary, the common compensation for enforcing a non-compete clause, is inadequate. In fact, if one were promised half of their salary during this non-compete period it might actually pencil out to only 30% of one's prior annual compensation when bonus, stock options and benefits are included. Can you imagine this occurring while one or two children are enrolled in college, or some other similar financial commitments?

In some financial situations a non-compete can obviously be disastrous to one's wealth. Many professionals with significant tenure, when terminated or changing firms are usually well advised to stay within the same industry. If you are one of these professionals you need to prepare for that worst scenario. Much of the financial literature recommends individuals maintain 3-6 months of cash, depending on one's financial situation, to cover living expenses during an emergency such as this scenario. The cash provides a buffer to pay bills while you rectify the situation. The cash reserve also prevents you from raiding your investment and retirement accounts, which often can also occur during the stress of poor market conditions such as during The Great Recession. In such situations, with enforcement of a one year non-compete clause, you might consider a larger cash savings such as one year of cash to cover expenses until you can begin collecting the pay check of new employment.

Non-compete clauses add another layer of complexity and challenge to anyone's wealth plan. You can typically expect to receive a much smaller portion of your annual compensation while the clause is being enforced, in this case 30% because of lost compensation and benefits. Additionally you won't be able to get disability insurance during this period adding even more risk to your wealth. If you have signed or need to sign a non-compete you should look at your own particular financial situation and consider increasing the cash reserves you need to survive the period of unemployment however remote those odds seem.

The approach we take with clients is to look at these planning scenarios as opportunities, not calamities. If there is any possibility you could leave your job or get terminated and need to sit on the sidelines for a year, how can we take advantage of this planning opportunity and prepare for its possible eventuality? How can you plan to turn this period of unemployment into an opportunity to allow you the time to achieve something else you have always wanted the time to do?

Todd Brundage is the President of Pacific Capital Works, a Registered Investment Advisor located in Portland, Oregon, that provides wealth management, retirement plans, investment management, and wealth planning services to entrepreneurs and executives and institutions. The firm has been ranked as one of the top advisors in Portland. And, Todd regularly contributes to a radio show named "Your Money" produced by the Wharton School of Business.