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The importance of the phrase caveat emptor

On May 24, 2012, in a 4-3 opinion written by Justice Lanzinger, the Supreme Court of Ohio held that while in a merger situation, noncompete agreements are assets that transfer to the successor entity, the enforceability of those noncompete agreements by the successor entity may be limited.[1] Thus, when contemplating any merger or asset sale, caution should be exercised to ensure that the successor entity understands to what extent it is able to enforce any contracts, including noncompete agreements, transferred as assets of the predecessor entity.

In *Acordia of Ohio, L.L.C. v. Fishel*, a successor company attempted to enforce noncompete agreements entered into by four employees with Acordia of Ohio, Inc. ("Acordia Inc.") or its predecessor companies between 1993 and 2000.[2] Each noncompete agreement provided that the employee would not compete with "the company" for a period of two years following termination of employment with "the company." Through a series of mergers, in December 2001, Acordia Inc. merged with Acordia of Ohio, LLC ("Acordia LLC") and ceased to exist. The four employees at issue worked for Acordia LLC until August 2005, at which time they went to work for a competitor. Relying on the noncompete agreements, Acordia LLC filed suit seeking injunctive relief, enforcement of the two year noncompete term and monetary damages. The requested relief was denied by both the trial and appellate courts, with the trial court granting, and the appellate court affirming, summary judgment in favor of the employees on these issues.[3] Acordia LLC appealed to the Supreme Court of Ohio asking that the Court find that the noncompete agreements

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"are enforceable by the surviving company according to the agreements' terms as if the surviving company were a party to the original agreements."[4]

The majority opinion of the Court began its analysis by first turning to the Ohio Revised Code provisions governing asset transfers. The Court noted that under R.C. 1701.82(A)(3) "[t]he surviving or new entity possesses all assets and property of every description, and every interest in the assets and property, wherever located, and the rights, privileges, immunities, powers, franchises, and authority, of a public as well as of a private nature, of each constituent entity… ." The Court reasoned that under this provision, it was clear that the noncompete agreements transferred to the acquiring company; however, the Court held that the "surviving company obtains the same bargain agreed to by the preceding company, nothing more."[5] Applying this holding to the facts presented, the Court found that because the noncompete agreements did not provide that they could be assigned or carried over to successors, the agreements were intended to operate only between the employees and the specifically named employers.[6] Thus, with respect to the four employees named as defendants, each employee's two-year noncompete period began to run from the date the company identified as the employer in his or her noncompete agreement was merged out of existence. The last of these mergers occurred in December 2001 when Acordia Inc. was merged with Acordia LLC. That meant that for the one defendant employee who signed a noncompete agreement with Acordia Inc., her noncompete period expired in December 2003, two years before she left Acordia LLC in 2005 to go to work for a competitor. Thus, the Court found that there was no noncompete period left to enforce.

In a strong dissent, Justice O'Donnell took issue with the majority's explanation and application of R.C. 1701.82(A)(3). Justice O'Donnell concluded that when assets transfer under statute, they do so without "reversion or impairment."[8] Justice O'Donnell agreed with the majority that "contract principles dictate that the agreements must be enforced according to their terms," but criticized the majority for failing to recognize that "the entity entitled to enforce those agreements is determined by statute."[9] Justice O'Donnell's dissent went on to draw a contrast between the majority opinion and the Court's prior holding in *Rogers v. Runfola & Assocs., Inc.*[10] In Rogers, employees signed noncompete agreements with a sole proprietorship that subsequently ceased to exist when its business structure changed to a corporation and the new corporation purchased all of the assets of the sole proprietorship.[11] Under these facts, the Court reasoned that "[o]nly the legal structure of the business changed, not the business itself" and that the change in corporate structure did not place additional burdens on the "duties or daily operations" of the employees.[12] Applying these principles, along with the holding in *ASA Architects, Inc. v. Schlegel,*[13] which held that "a properly executed contract is binding on the surviving entity 'in a merger unless the agreement explicitly sets forth that in the event of merger, the obligations of the constituent corporation cease to exist,'"[14] Justice O'Donnell concluded that Acordia LLC should have been able to enforce the noncompete agreements as if they were a signatory to the same.[15]

Employers are undoubtedly left asking how this decision impacts their ability to enforce any existing noncompete agreements and what can be done to protect that ability going forward. The first step necessary to answer that question is a review of the existing agreements. If any of the agreements were entered into by employees with predecessor employers and the agreements do not contain language allowing for the assignment or carry over to successors or assigns, the employer should take that next step and draft new noncompete agreements identifying the current employer and its successors and assigns as the contracting party. If these steps are not taken, an employer may find itself faced with no way of stopping significant competition that would have otherwise been prohibited by an enforceable noncompete agreement. Going forward, employers should also be watchful of how this decision is applied with regard to other corporate contracts and other forms of business reorganization. ◆

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Endnotes

[1] *Acordia of Ohio, L.L.C. v, Fishel,* Slip Opinion No. 2012-Ohio-2297.
[2] *Id.*
[3] *Acordia of Ohio, L.L.C. v. Fishel*, 1st Dist. No. C-1000071, 2010-Ohio-6235.
[4] *Acordia of Ohio, L.L.C. v. Fishel*, 128 Ohio St.3d 1458, 2011-Ohio-1829, 945 N.E.2d 522.
[5] *Acordia of Ohio, L.L.C.*, Slip Opinion No. 2012-Ohio-2297 at ¶15.
[6] *Id.* at ¶12.
[7] The other three defendant employees' noncompete agreements identified another predecessor as the employer and that predecessor was merged out of existence in December 1997, meaning the two year noncompete period for these employees expired in December 1999.
[8] *Acordia of Ohio, L.L.C.*, Slip Opinion No. 2012-Ohio-2297 at ¶25 (O'Donnell, J., dissenting).
[9] *Id.* at ¶28.
[10] 57 Ohio St.3d 5, 565 N.E.2d 540 (1991).
[11] *Id.* at 7.
[12] *Id.*
[13] 75 Ohio St.3d 666, 665 N.E.2d 11083 (1996).
[14] *Id.* at syllabus.
[15] *Acordia of Ohio, L.L.C.*, Slip Opinion No. 2012-Ohio-2297 at ¶¶27, 30, 33 (O'Donnell, J., dissenting).