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Enforceability of Non-Compete Agreements Following a Merger: Supreme Court of Ohio Overrules Earlier Decision

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With the use of instant replay, fans frequently hear the referee say, "The previous play is under further review." Unlike football referees, courts rarely reconsider their own decisions, but on October 11, 2012, the Supreme Court of Ohio reversed its decision from five months earlier. The Court agreed to reconsider the puzzling decision it had rendered in *Acordia of Ohio, L.L.C. v. Fishel*, ("*Acordia I*"), where it had held that a non-compete agreement entered into by an employee of a corporation that later merges, is unenforceable by the surviving company after the merger. Upon a motion for reconsideration, the Court reversed itself and held that the surviving company after a corporate merger has the right to enforce non-compete agreements as if it has stepped into the shoes of the contracting companies ("*Acordia II*").

Acordia I

In *Acordia I*, the Court caused quite a commotion among corporations and their attorneys, when the Court held that the surviving company after a merger cannot enforce a non-compete agreement entered into prior to the merger, unless the agreement contained language that expressly made it enforceable by "successors and assigns." The Court's reasoning in *Acordia I* was based, in part, on a 1971 decision which stated "[a] merger involves the absorption of one company by another, the latter retaining its own name and identity, and acquiring the assets, liabilities, franchises and powers of the former. Of necessity, the absorbed company ceases to exist as a separate business entity." Based on this language, the Court reasoned non-compete agreements were unenforceable because the entities with which the employees had agreed not to compete no longer existed after the mergers. Further, the Court said that without language stating the non-compete agreements could be enforced by "successors and assigns," the agreements could be enforced only by "the specific company named in the agreements." This interpretation of Ohio's merger statute came as a surprise to many corporate attorneys.

Acordia II

In *Acordia II*, the Court acknowledged that its decision in *Acordia I* was "erroneous" and based on "misreading" of the 1971 *Morris* case. The Court clarified, "While *Morris* does state that the absorbed company ceases to exist as a *separate* business entity, the opinion does not state that the absorbed company is completely erased from existence. Instead, the absorbed company becomes a part of the resulting company following merger." Accordingly, the surviving company can enforce the non-compete

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agreements post-merger, and the absence of "successors and assigns" language does not prevent enforcement. The Court expressly limited its *Acordia II* decision to non-compete agreements, and cautioned the ruling may not apply to other company contracts following a merger. Nonetheless, the Court's reasoning logically would seem to apply to other types of contracts as well.

Although the surviving company may enforce a pre-merger non-compete agreement, the agreement still is subject to the same reasonableness test as any other non-compete. It must not impose unreasonable restrictions upon the employee, and will be enforced only to the extent necessary to protect the employer's legitimate business interests. In *Acordia II*, the Court remanded the case to the trial court to decide the reasonableness of the parties' non-compete agreements.

Acordia II is limited to mergers, not asset purchase agreements, which normally include assignment of non-compete agreements to the purchaser. The law of Ohio remains uncertain whether non-compete agreements are enforceable by the purchaser/assignee without express successors and assigns language in the agreements. Some courts take a very restrictive view, and prohibit assignment as a matter of law or allow assignment only if assignability is specifically approved by the employee, either in the agreement itself or by subsequent agreement with the successor entity. Other courts are more liberal and generally allow assignment of non-compete agreements unless there is specific language in the agreement prohibiting assignment. Therefore, even after *Acordia II*, employers and certainly purchasers buying the assets of a corporation should make sure non-compete agreements explicitly state they are enforceable by successors and assigns.

Conclusion

In conclusion, there are some simple takeaways from the *Acordia II* decision:

- Following a corporate merger, the surviving company can enforce non-compete agreements as if it had stepped into the original contracting company's shoes.
- In a merger transaction, non-compete agreements need not contain successors and assigns language in order for the surviving company to enforce them, but such language is nevertheless advisable when drafting such agreements, to ensure they will be enforceable after an asset sale.
- Whether acquired by merger or asset purchase, in order to be enforceable under any circumstance, the terms of non-compete agreements must be evaluated to determine if they are reasonable under the circumstances. Generic non-compete agreements may be attacked as unreasonable unless tailored to the employer's business.

If you have any questions about this or any other corporate law issue, please contact a member of Eastman & Smith's Business Law Practice Group at 419-241-6000 or visit our website at www.eastmansmith.com.