REASONABILITY OF RESTRICTIVE COVENANTS; DEFEND TRADE SECRETS ACT

CMBA LABOR & EMPLOYMENT ANNUAL CONFERENCE

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I. *RAIMONDE V. VAN VLERAH*, 42 OHIO ST.2D 21 (APRIL 2, 1975)

A. LANDMARK OHIO DECISION

1. When a covenant not to compete imposes unreasonable restrictions upon an employee, it will only be enforced to the extent necessary to protect the employer's legitimate interests.

2. Tripartite test for determining reasonability:

    a. Restriction is no greater than required for the protection of the employer.

    b. Does not impose undue hardship on the employee.

    c. Is not injurious to the public.

B. FACTORS TO BE CONSIDERED IN EVALUATING REASONABLENESS

1. The absence or presence of limitation as to time and space.

2. Whether the employee represents the sole contact with the customer.

3. Whether the employee possesses confidential information or trade secrets

4. Whether the covenant seeks to eliminate competition which would be unfair to the employer or merely seeks to eliminate ordinary competition.

5. Whether the covenant seeks to stifle the inherent skill and experience of the employee.

6. Whether the benefit to the employer is disproportional to the detriment of the employee.

7. Whether the covenant operates as a bar to the employee's sole means of support.

8. Whether the employee's talent which the employer seeks to suppress was actually developed during the period of employment.

9. Whether the forbidden employment is merely incidental to the main employment.

C. MODIFIES EXISTING BLUE PENCIL TEST

Prior to *Raimonde,* the "blue pencil" test in Ohio allowed courts to strike offending provisions from employment contracts. However, this early "blue pencil" test precluded modification or amendment; therefore, if the offending provisions were integral to the parties' agreement, the entire contract would fail once stricken.

The *Raimonde* court adopted a "reasonableness" test which "permits courts to fashion a contract reasonable between the parties, in accord with their intention at the time of contracting, and enables them to evaluate all the factors comprising a reasonableness in the context of employee covenants."

After *Raimonde*, courts were permitted not only to strike, if divisible, the restrictive covenants in employment contracts, but were also permitted to rewrite and modify terms in order to fashion a reasonable agreement based on the facts and circumstances of the case.

II. FACT INTENSIVE

The reasonableness of the covenant not to compete must be decided on its own facts and a reviewing court is to apply a totality of the circumstances test.

1. A plaintiff seeking to enforce a restrictive covenant must establish, by clear and convincing evidence, each of the three *Raimonde* elements.

2. A few courts have determined that, due to the factually dependent nature of the reasonableness inquiry, summary judgment is inappropriate as it relates to the interpretation of a restrictive covenant. *Salon Communications Services, Inc. v. Gradowski*, (Franklin Cty. C.P. 2013), 2013 Ohio. Misc. LEXIS 16883.

III. TEMPORAL AND GEOGRAPHICAL RESTRICTIONS

The Ohio Supreme Court has long recognized the validity of agreements that restrict competition by an ex-employee but only if they contain reasonable geographical and temporal restrictions. *Lake Land Empl. Group of Akron, LLC vs. Columber* (2004), 101 Ohio St.3d 242.

A. **Temporal Restrictions**. Recent case law in Ohio does not reveal any definitive patterns as to a universal reasonable temporal restriction for non-competes. As the case law indicates, the determination is based on the individual facts of each case and relies on a totality of the circumstances analysis. A summary of recent cases in Ohio reveals the following:

1. *Facility Services and Systems v. Vaiden*, (8th Dist. 2006), 2006-Ohio-2895. In reviewing a two-year non-compete with no geographical limitation, the court noticed that one year time limitations have been repeatedly held to be a reasonable period of time for non-compete agreements. The court held that two years in this matter was unreasonable as the employee was not the sole customer contact. The court also found that though the employee had access to confidential

information, other similarly situated employees were not required to sign such agreements. Furthermore, the employer conceded that there was "no evidence that [employee] disclosed confidential information." The court also found that the restrictions prohibiting what the employee could perform were vast and far reaching, significantly wider than the functions he had performed for the employer. Finally, the temporal restriction would negate the employee's sole means of support, given his skills and past experience in that area. As a result, the court found that the entire agreement was unenforceable and was struck.

2. Likewise, a two year restriction was stricken by the Lucas County Court of Appeals in *Murray v. Accounting Center and Tax Services* (6th Dist. 2008), 178 Ohio App.3d 432. There, the court found that two years was unreasonable as the employee had worked, for 16 years, in whole or in part by doing tax preparation work. Accordingly, the court modified the 24 month restriction to one year after 60 days from the order and prohibited the employee from servicing clients of the former employer.

3. In *LHR Holdings v. Able Roofing*, (Franklin Cty. C.P. 2012), 2012 Ohio Misc. LEXIS 1045), the Franklin County Court of Common Pleas modified a three year non-competition agreement down to two years. The court there found that the former employee has received sensitive and proprietary customer information. Furthermore, the court held that he employer had the right to protect the good will it had earned as a successful roofing company in the community. The court also pointed out that the employee had received the advice of counsel while negotiating the restrictive covenant and had agreed to the three year limitation in return for a higher rate of commission on work performed for the employer. Because the parties had equal bargaining power, the court found that the employer had the right to significantly limit the right of the employee to continue work in the same area, but felt that three years was unreasonably long and modified it to <u>two years</u>.

4. In *Life Line Screening of America Ltd. v. Calger*, (Cuyahoga C.P. 2006), 145 Ohio Misc.2d 6), the Cuyahoga County Court of Common Pleas found that a two year restrictive covenant was reasonable in light of the amount of experience and training that the employer provided the employee over approximately eight years and the significant level of funding and risk that the employee undertook to develop the business processes and testing protocols that the former employee intended to use. The court found that the confidential and proprietary information that would be unfairly used to the detriment of the former employer warranted a two year restriction.

5. In upholding a two year restriction in *Castillejo v. Associates in Anesthesiology, Inc.* (Mahoning Cty. C.P. 2013), 2013 Ohio Misc. LEXIS 7252, the Mahoning County Court of Common Pleas found that "Ohio law finds the enforcement of contractual obligations to be of itself an important social policy interest." The court in Mahoning County found that numerous Ohio decisions had upheld a two

year period or longer and that two years was warranted there as the restrictive covenant in question did not seek to stifle the former employee's inherent skills and experience nor did it operate as a bar to his sole means of support.

B. Geographical Restrictions.

1. In determining the reasonableness of geographical limitations, courts will look to a number of different factors including the amount of work the employee has performed within the former employer's major service area. In *Lindsey Construction and Design v. Luttrell* (5th Dist. 2014), 2014-Ohio-1720, the Stark County Court of Common Pleas found that the former employee's new employer did less than 1% of its business in the former employee's major service area. Also taken into account was the fact that there was no proof presented by the former employer of any direct solicitation of its customers or businesses leading to the loss of any clientele. Accordingly, the court found that the 100 miles geographical limitation was overbroad.

2. In *Try Hours, Inc. v. Douvill* (6th Dist. 2013), 2013-Ohio-53, the Lucas County Court of Common Pleas held that a nationwide restriction was reasonable when the restriction only prohibited the former employee from engaging in business in the "expedited freight industry" when the employee could perform work in the general "trucking industry." The court found that the restriction did not prohibit the employee from finding secure employment during the one year that the non-compete was in effect.

3. In *American Logistics Group, Inc. v. Weinpert* (8th Dist. 2005), 2005-Ohio-4809, the Eighth District Court of Appeals upheld a 75 mile restriction based on the nature of the work performed by the employee. The court found that the employee engaged in the very competitive computer industry and that jobs were obtainable outside of the 75 mile restricted area. The court took into account that the employer had taken years to build the American client base and that most of the employer's business and reputation was based on word of mouth referrals. Furthermore, there was evidence that the employer's clients required and depended upon closed contact with its consultants, including the former employee. Accordingly, the court found that "this close contact increases the opportunity for an employee to leave the company and take [employer's] clients."

IV. ORDINARY V. UNFAIR COMPETITION

A court determining the enforceability of a covenant not to compete must analyze "whether the covenant seeks to eliminate competition which would be unfair to the employer or merely seeks to eliminate ordinary competition." *Mark Philips Salon/Spa v. Blessing*, (2nd Dist. 2011), 2011-Ohio-388, citing *Raimonde* at 25. The *Raimonde* court held that "covenants not to compete are valid only when the competition they restrict is somehow unfair, not because it is unfair that the promisor fails to perform on the promise he made." Likewise, in *Blessing*, the court found that the employee who was subject to the non-compete was an experienced

hairdresser and brought numerous clients with her to her employer. While with the employer, the employee did not receive any particular training or skill that she used after leaving. Furthermore, there was no evidence that she obtained any confidential proprietary information such as customer lists or databases maintained by the employer.

As a result, the court found "on the record there is nothing in the competition with [employer] in which [employee] has engaged that makes it unfair. [Employee] uses no trade secrets or competitive advantages she obtained from [employer]. The competition [employer] seeks to prevent is merely ordinary competition. Therefore, the covenant not to compete cannot be enforced."

Likewise, in *Animal Hospital of Polaris v. Cole* (Franklin Cty. C.P. 2015), 2015 Ohio Misc. LEXIS 1499, the Franklin County Court of Common Pleas found that a non-compete entered into by an employee "with pre-existing skills for a position which does not have a strong influence on clients, and who seek employment following termination with an ordinary competitor does not constitute unfair competition." Accordingly, the court found that it was unduly burdensome on employees to enforce an employer's protection from ordinary competition.

V. SALE OF BUSINESS

Like employment cases, the facts related to the reasonability of such restrictive covenants are paramount. In *Century Business Services v. Urban* (8th Dist. 2008), 179 Ohio App.3d 111, the Eighth District Court of Appeals held that the restrictive covenants entered into ancillary to the sale of business should be afforded less scrutiny than those entered into by employees as consideration for employment. The court reviewed an Eleventh District case in which a 15 year restriction was upheld as it related to the sale of business. The court also took note of the fact that time limitations of 10 years have been found to be valid as long as the buyer of a business remains in the city where the subject business was purchased.

The basis for finding employment agreements ancillary to the sale of business "particularly conscionable" is because the seller is usually paid an increased price for agreeing to a period of abstention.

> The abstention is the part that is sold and is necessary in order to secure the buyer the things he has bought. [D]ifferent considerations apply – there is more freedom of contract between seller and buyer than between employer and employee – the latitude of permissible restraint is even more limited between employer and employee, greater between seller and buyer. * * * The average, individual employee has little but his labor to salary used to make a living. He is often in urgent need of selling it and in no position to object to boilerplate restrictive covenants placed before him to sign. To him, the right to work and support his family is the most important right he possesses. His individual bargaining power is seldom equal to that of the employer. Moreover, an employee ordinarily is not the same plane with the seller of an established business.

Furthermore, in Ohio, non-compete agreements are generally assignable. *Rogers v. Runfola & Assoc., Inc.* (1991), 57 Ohio St.3d 5. While the law in Ohio is that non-compete agreements are one of many contractual rights which may be assigned, some courts have disagreed on whether both parties must agree to the assignment before it is assignable.

At least one court, the Belmont County Court of Appeals, found that the controlling factor in determining the assignability of a covenant not to compete is the intention of the contracting parties. In such a situation, the court must determine whether the specific employee's language to demonstrate that the assignability of the non-compete was contemplated by the parties. *Artromick International, Inc. v. Koch* (10th Dist. 2001), 143 Ohio App.3d 805. Some courts prohibit assignment or allow it only if the assignability is specifically approved to by the employee either in the agreement itself or in a subsequent agreement with the successor business entity.

VI. PHYSICIAN NON-COMPETITION AGREEMENTS

The American Medical Association has stated that non-compete agreements should be discouraged as they relate to physicians. The basis for this is the premise that it is vital that the health and expectations of patients, who are generally unaware of private agreements among physicians, be adequately protected.

"It is also important that competition among physicians be encouraged in these times of increasing health care costs. The harm imposed on the public by physician non-competition agreements can be especially acute in certain rural areas and/or when the physician practices a specialized type of medicine." *Kidney and Hypertension Specialists Chillicothe v. Adena Health System, et al.* (Franklin Cty. C.P. 2014), 2014 Ohio Misc. LEXIS 9317.

VII. DECLARATORY ACTION

Declaratory actions may be utilized to determine the reasonableness of an agreement. In *LHR Holdings, supra,* the Franklin County Court of Common Pleas found that R.C. 2721.03 permits a court to determine the reasonableness of a non-compete regardless of the fact that the controversy turns upon a question of fact as "legal consequences [naturally] flow from the existence of fact."

VIII. TRADE SECRETS/INEVITABLE DISCLOSURE

In determining the reasonableness of restrictive covenants, the *Raimonde* court held that a factor to be taken into consideration is whether the employee is possessed with confidential information or trade secrets often times taking the form of customer lists. In some cases, the mere knowledge of this information may give rise to a theory of liability known as "inevitable disclosure."

In such a matter, courts deem that the knowledge of intellectual property while working for a competitor of the employer where the knowledge was obtained gives rise to the almost inevitable likelihood that that knowledge will be used by the competitor.

In *Litigation Management, Inc. v. Bourgeois* (8th Dist. 2011), 2011-Ohio-2794, the Eighth District Court of Appeals held:

> Non-competition agreements are, at bottom, a category of intellectual property regulation because the harm sought to be avoided is that an employee will know so much about the former employer that it will give a new and directly competing employer an unfair competitive advantage.

The inevitable disclosure doctrine holds that a threat of harm warranting injunctive relief exists when an employee with specialized knowledge commences employment with a competitor. Courts have held that the rule is justified because "it is very difficult for the human mind to compartmentalize and selectively suppress information once learned, no matter how well intentioned the effort may be to do so."

The rule is applied when a former employer seeks injunctive relief when a former employee begins work with a competitor while the non-competition clause has not expired. *Id.*

IX. CONSIDERATION FOR NON-COMPETE

The Ohio Supreme Court definitively set forth in *Lake Land Empl. Group of Akron, LLC vs. Columber* (2004), 101 Ohio St.3d 242, that an at-will employment is contractual in nature insofar as an employee agrees to perform work under the direction and control of an employer, and in return the employer agrees to pay the employee. Under such an arrangement, either party may terminate the employment relationship at any time for any reason. The court held that based on this at-will relationship, either employer or employee can change the terms of their employment relationship at any time. The court found that such a change included the insertion of a non-compete clause into the relationship:

> The presentation of a noncompetition agreement by an employer to an at-will employee is, in effect, a proposal to renegotiate the terms of the party's at-will employment. Where an employer makes such a proposal by presenting his employee with a noncompetition agreement and the employee assents to it, thereby accepting continued employment on new terms, consideration supporting the noncompetition agreement exists. The employee's assent to the agreement is given in exchange for forbearance on the part of the employer from terminating the employee.
>
> We therefore hold that consideration exists to support noncompetition agreement when, in exchange for the assent of an at-will employee to a proffered noncompetition agreement, the employer continues an at-will relationship that could be legally terminated without cause.

The Eighth District Court of Appeals has upheld this premise. See, *Century Business Services v. Barton* (8th Dist. 2011), 197 Ohio App.3d 352.

X. DEFEND TRADE SECRETS ACT OF 2016, AMENDING 18 U.S.C. SECTION 1832, et seq.

A. Creates a new federal cause of action for trade secret misappropriation.

1. Signed into law by President Obama on May 11, 2016.

2. It creates a uniform, federal standard for the protection of corporate trade secrets.

3. Companies that operate in numerous states can seek relief for trade secret misappropriation without regard to differences in state law.

4. Does not alter or circumvent state laws regarding enforceability of non-compete agreements.

5. DTSA does not preempt state trade secret laws, to the extend they provide greater protection.

6. Provides for the civil seizure of property "necessary to prevent the propagation or dissemination of the trade secret that is the subject of the action" in "extraordinary circumstances."

7. In addition to civil seizure, other traditional remedies are also available including injunctions, compensatory damages, exemplary damages and attorneys' fees.

8. Exemplary damages are limited to two times the amount of the compensatory damages and attorneys' fees are only available upon proof that the misappropriation was "willful and malicious."

9. A defendant may obtain attorneys' fees against a plaintiff is the defendant can prove that the claim was brought in bad faith.

10. Provides immunity when the disclosure of trade secrets is made in confidence to a government official or to an attorney for the purpose of reporting or investigating a suspected violation of law, i.e. whistleblowing.

11. DTSA requires that employees provide notice of the immunity provisions in "any contract or agreement with an employee that governs the use of trade secret or other confidential information." This requirement applies to all agreements entered into or updated after May 11, 2016. "Employees" is defined broadly to include "any individual performing work as a contractor or consultant for an employer."

12. If an employer fails to comply with the requirement, it can be awarded exemplary damages or attorneys' fees in an action against an employee to whom notice was not provided.

13. Congress' desire to align closely with the Uniformed Trade Secrets Act which has been adopted in some form by almost every U.S. state.

B. Considerations Moving Forward:

1. Update and revise employment agreements and contracts.

2. Utilize both state and federal causes of action.

3. Allow for law surrounding *ex parte* seizures to develop.