ASSIGNABILITY OF COVENANTS NOT TO COMPETE UNDER PENNSYLVANIA AND OHIO LAW

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I. INTRODUCTION

Covenants not to compete are often included in many employment agreements. Covenants not to compete provide employers with a useful and effective way of protecting their intangible assets, such as customer goodwill and confidential and trade secret information. Covenants help to ensure that an employer's assets are not jeopardized and used to their competitive disadvantage as employees leave and go to work for a competitor.

In recent years, as companies have been bought and sold, merged and liquidated, there has been a question of whether covenants not to compete signed between an employee and one company can be assigned to another company. Pennsylvania and Ohio have answered this question differently. Pennsylvania has held that unless an employment agreement contains a specific assignability clause or the employee consents to the assignment, a covenant not to compete cannot be assigned. In contrast, Ohio has a more lenient approach to assignability, with courts holding that contracts with covenants not to compete may be assigned even absent a specific assignability provision.

II. PENNSYLVANIA LAW

A. The Law Prior to 1997

Prior to 1997, no Pennsylvania appellate court had directly addressed the issue of whether a covenant not to compete could be assigned by an employer.[2] However, a few trial court decisions found that such covenants could not be assigned.[3] For example, in *Armstead v.*

[1] Special thanks to Michael Spitzer for his assistance with this article.
[2] *All-Pak, Inc. v. Johnston*, 694 A.2d 347, 351 (Pa. Super. 1997).
[3] *Id.*

Miller,[4] the Court of Common Pleas of Allegheny County held that such covenants not to compete are not assignable unless they include language expressly allowing assignment. Two other trial court decisions created an exception to this rule, enforcing the restrictive covenant where the employee, expressly or implicitly by his conduct, consented to the assignment.[5]

In addition, two Pennsylvania Supreme Court cases prior to 1997 dealt tangentially with the assignment of employment covenants. In *Seligman & Latz of Pittsburgh v. Vernillo*,[6] the Supreme Court of Pennsylvania held that an employment covenant could still be enforced by an employer who merely changed its form from a partnership to a corporation. Similarly, the Supreme Court in *Alabama Binder & Chem. Corp. v. Pennsylvania Indus. Chem. Corp.*[7] held that a restrictive covenant made in conjunction with a buy-sell agreement was enforceable because covenants not to compete, which are ancillary to a buy-sell agreement, are not subject to the same high level of scrutiny as those covenants entered into as part of an employment contract.

B. The *All-Pak* Decision

In 1997, the Pennsylvania Superior Court directly addressed the issue of assignability of covenants not to compete in *All-Pak, Inc. v. Johnston*.[8] Johnston signed an employment agreement with All-Pak that contained a two-year covenant not to compete.[9] A few years later, All-Pak entered into an asset purchase agreement with an investment group named Total-Pak, Inc.[10] Total-Pak purchased all of the assets, and then changed its name to All-Pak.[11] Johnston

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[4] *Armstead v. Miller*, 52 D.&C.2d 584 (Pa. Comm. Pl., Allegheny County 1971).
[5] *See*, *e.g.*, *Jack Tratenberg, Inc. v. Komoroff*, 87 Pa. D.&C. 1 (Pa. Comm. Pl., Philadelphia County 1951); *Green's Dairy Inc. v. Chilcoat*, 89 Pa. D.&C. 351 (Pa. Comm. Pl., York County 1954).
[6] *Seligman & Latz of Pittsburgh v. Vernillo*, 382 Pa. 161, 114 A.2d 672 (1955).
[7] *Alabama Binder & Chem. Corp. v. Pennsylvania Indus. Chem. Corp.*, 410 Pa. 214, 189 A.2d 180 (1963).
[8] *All-Pak, Inc. v. Johnston*, 694 A.2d 347 (Pa. Super. 1997).
[9] *Id.* at 349.
[10] *Id.*
[11] *Id.*

worked for the new All-Pak until he was terminated in 1995.[12] Following this termination, Johnson accepted employment with a competitor, allegedly in violation of his covenant.[13] All-Pak then filed suit seeking a preliminary injunction against Johnston for breach of the covenant.[14] The trial court denied All-Pak's request for injunctive relief, finding that there was both a lack of an assignability provision in the contract and a lack of consent to assignability by Johnston; All-Pak could not enforce the covenant against Johnson.[15] The Superior Court agreed with the trial court, holding that "absent an explicit assignability provision, courts should be hesitant to read one into the contract."[16]

C. The *Hess* Case and the Current State of the Law

Between 1997 and 2002, the *All-Pak* decision was the only direct Pennsylvania authority on the assignability of covenants not to compete. However, that changed in 2002 when the Pennsylvania Supreme Court directly decided the issue in *Hess v. Gebhard & Co. Inc*.[17] In a case of first impression, the Supreme Court held that a covenant not to compete is not assignable to a purchasing business unless there is a specific assignability provision in the employment contract.[18]

Hess signed an employment agreement with Eugene Hoaster Company, Inc. ("Hoaster") to become an insurance agent.[19] As part of his employment agreement, Hess consented not to compete with Hoaster within a twenty-five mile radius of the City of Lebanon for a period of five years after the termination of his employment.[20] However, the covenant not to compete

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[12] *Id.*
[13] *Id.*
[14] *Id.*
[15] *Id.* at 351-52.
[16] *Id.* at 351.
[17] *Hess v. Gebhard & Co. Inc.*, 570 Pa. 148, 808 A.2d 912 (2002).
[18] *Id.* at 166-67, 808 A.2d at 922.
[19] *Id.* at 152, 808 A.2d at 914.
[20] *Id.* at 152-53, 808 A.2d at 914.

contained no language regarding assignability.[21] In July, 1996, Hoaster sold all of its assets to Mr. Brooks, including Hess' employment contract.[22] Hess did not consent to the assignment of his covenant to Brooks.[23] In November, 1996, Hess' position at Hoaster was eliminated, and he began employment negotiations with a rival insurance agency named Bowman's.[24] Hoaster then sent a letter to Hess and Bowman's warning them about the covenant not to compete contained in Hess's employment agreement and threatened legal action if Hess worked for Bowman's.[25] As a result of the letter, Hess did not receive a job offer from Bowman's.[26] Hess then filed suit against Hoaster, claiming that the assignment of his employment contract was illegal.[27]

The Pennsylvania Supreme Court began by noting that "restrictive covenants are not favored in Pennsylvania and have been historically viewed as a trade restraint that prevents a former employee from earning a living."[28] The court also agreed with the *All-Pak* court that covenants should be read narrowly and that courts should hesitate to read an assignability provision into a contract.[29] Moreover, the Supreme Court was persuaded that an employment contract is a unique, trusting relationship between an employee and an employer.[30] The Supreme Court held that "just because an employee has trust in one employer does not automatically mean that the employee would be willing to suffer a restraint on his employment for the benefit of a stranger to the original undertaking."[31] Therefore, the court held that a covenant not to compete contained in an employment agreement is not assignable to the purchasing business entity in the

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[21] *Id.*, 808 A.2d at 914-15.
[22] *Id.* at 154, 808 A.2d at 915.
[23] *Id.*
[24] *Id.* at 155, 808 A.2d at 915.
[25] *Id.*
[26] *Id.*
[27] *Id.*
[28] *Id.* at 157, 808 A.2d at 917.
[29] *Id.* at 166, 808 A.2d at 922.
[30] *Id.*
[31] *Id.*

absence of a specific assignability provision where the covenant is included in a sale of assets.[32] The upshot of *Hess* is that unless an employer includes a specific assignability provision that applies to the covenant not to compete, a covenant cannot be assigned to a subsequent employer.

Following *Hess*, the Superior Court of Pennsylvania in *Allegheny Anesthesiology Associates, Inc. v. Allegheny General Hosp.*, 826 A.2d 886 (Pa. Super. 2003) again addressed the assignability of covenants. Relying primarily upon *All-Pak*, the Superior Court held that covenants contained in employment contracts of certified registered nurse anesthetists could not be assigned to another entity because the employment contracts did not contain an assignment provision.[33] The Superior stated: "AAA [Allegheny Anesthesiology Associates], as the employer and drafter of the contract, was certainly in a better position to include such a provision if it so desired."[34] The court also refused to recognize the validity of the assignment because, consistent with *Hess*, enforcement of the covenants would have materially altered the duties and responsibilities of the anesthetists.[35] Thus, the Superior Court took perhaps a less restrictive view on the assignability of covenants not to compete than the *Hess* court, requiring an assignability provision in the employment contract itself.

III. OHIO LAW

In contrast to Pennsylvania, Ohio law more readily permits the assignability of covenants not to compete. While the state Supreme Court of Ohio has never directly addressed the issue, most lower Ohio courts have held that assignability of covenants not to compete is permissible, even in situations where the contract is silent with regard to assignability or the employee has not specifically consented.

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[32] *Id.* at 166-67, 808 A.2d at 922.
[33] *Id.* at 892.
[34] *Id.*

A. Supreme Court decisions

The Supreme Court of Ohio has addressed the issue of assignability only tangentially. In *Rogers v. Runfola & Associates, Inc.*,[36] the court addressed whether a covenant not to compete could be assigned when a company merely changed from a sole proprietorship to a corporation. In 1971, Runfola started a sole proprietorship named Runfola and Associates that acted as a court reporting service.[37] In 1972, Rogers then began working for Runfola and in 1975 signed an employment contract containing a covenant not to compete for a period of two years on a county-wide basis.[38] Then, in February 1977, Runfola incorporated the business and shortly thereafter transferred the assets and liabilities, including the employment contracts, from the sole proprietorship to the corporation.[39]

In April 1988, Rogers submitted a letter of resignation along with another long-time employee named Marrone.[40] At the time of resignation, both Rogers and Marrone indicated that they intended to start their own local court-reporting firm.[41] Runfola then sent letters to Rogers and Marrone reminding them of their covenants not to compete and then sought specific enforcement of the covenant through an injunction.[42]

The trial court and the state court of appeals held that the covenants not to compete were unenforceable.[43] The Ohio Supreme Court disagreed, stating that because only the legal structure of the business had changed, not the business itself, and because Rogers testified that

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[35] *Id.* The validity of assignment of the covenants not to compete was addressed by the court as a result of AAA's purported assignment of the employment contracts to the University of Pittsburgh Medical Center.
[36] *Rogers v. Runfola & Associates*, 57 Ohio St.3d 5, 565 N.E.2d 540 (1991).
[37] *Id.* at 5, 565 N.E.2d at 541.
[38] *Id.*
[39] *Id.*
[40] *Id.* at 6, 565 N.E.2d at 541.
[41] *Id.*, 565 N.E.2d at 542.
[42] *Id.*
[43] *Id.*

the incorporation made no changes in her employment, the covenant not to compete was assignable and therefore enforceable.[44]

B. Lower Court Decisions

While the Ohio Supreme Court has only addressed the issue of assignability of covenants not to compete tangentially, lower court decisions have addressed the issue directly. In *Artromick International, Inc. v. Koch*,[45] the Ohio Court of Appeals held that covenants not to compete could be assigned absent a specific assignability provision in the contract. The facts of the case are similar to other assignability cases. Koch signed an employment agreement with Drustar, Inc., and the contract included a one-year non-competition clause.[46] The employment agreement contained no provision governing the assignability of any of its provisions.[47]

Koch resigned from Drustar in early 1999, but a few days later, Drustar entered into an asset purchase agreement with Artromick International, Inc., whereby all contracts and assets of Drustar were sold to Artromick.[48] The contracts sold included the rights under the non-competition agreement with Koch.[49] Artromick then filed suit against Koch, seeking enforcement of the non-competition agreement and damages.[50]

The trial court ruled that the non-competition clause could not be assigned.[51] However, the Court of Appeals reversed the trial court and held that non-competition clauses could be assigned.[52] The court noted that "Ohio case law on the subject, while sparse, appears to take a less restrictive approach - allowing assignment of covenants not to compete without specific

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[44] *Id.* at 7, 565 N.E.2d at 543.
[45] *Artromick International, Inc. v. Koch*, 143 Ohio App.3d 805, 759 N.E.2d 385 (2001).
[46] *Id.* at 806, 759 N.E.2d at 385-86.
[47] *Id.*, 759 N.E.2d at 386.
[48] *Id.*
[49] *Id.*
[50] *Id.*
[51] *Id.*
[52] *Id.* at 810, 759 N.E.2d at 389.

provisions for their assignability."[53] The court also found that in other similar cases, Ohio courts have upheld the assignment of covenants not to compete absent specific approval of such assignability by the employee.[54] In addition, because no additional burdens were placed upon Koch since he resigned prior to the asset sale, the argument for assignment was bolstered.[55] Therefore, the Ohio Court of Appeals allowed assignability in this case.

Another Ohio Court of Appeals case, *Blakeman's Valley Office Equipment v. Bierdeman*,[56] also held that covenants not to compete are assignable. In this case, Bierdeman had an employment contract containing a covenant not to compete with Copeco, Inc. (Copeco).[57] The contract as a whole, but not the covenant not to compete clause, had an assignability provision.[58] Copeco then entered into an asset sale agreement with Blakeman's Valley Office Equipment ("Blakeman") which included Bierdeman's employment contract.[59] Blakeman then sought a preliminary injunction against Bierdeman based on the assigned covenant not to compete.[60] At the trial court level, the preliminary injunction was denied because Blakeman was not the original party to the covenant not to compete.[61] However, the Ohio Court of Appeals reversed the trial court's decision, stating that noncompetition agreements are assignable in Ohio.[62] The court cited *Artromick* for the proposition that covenants not to compete are assignable even if the contract is silent as to assignability.[63] Appellee, however, argued that because the covenant not to compete itself did not contain an assignability provision, the

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[53] *Id.* at 808, 759 N.E.2d at 387 (citing *Safier's, Inc. v. Bialer*, 93 N.E.2d 734 (1950).
[54] *Id.* at 809, 759 N.E.2d at 388 (citing *Beta LaserMike, Inc. v. Swinchatt*, 2000 WL 262628 (2000); *C.A. Litzler Co., Inc. v. Libby*, 1991 WL 160850 (Ohio Ct. App. 1991)).
[55] *Id.* at 810, 759 N.E.2d at 389.
[56] *Blakeman's Valley Office Equipment, Inc. v. Bierdeman*, 152 Ohio App.3d 86, 786 N.E.2d 814 (2003).
[57] *Id.* at 88, 786 N.E.2d at 915.
[58] *Id.* at 88-89, 786 N.E.2d at 916.
[59] *Id.* at 89, 786 N.E.2d at 916.
[60] *Id.*
[61] *Id.*
[62] *Id.* at 90, 786 N.E.2d at 917.

covenant not to compete could not be assigned.[64] However, the court held that the assignability provision in the contract covered the covenant not to compete, so the covenant could be assigned.[65] In addition, assignment was even more proper when, as here, appellee's obligations under the non-compete clause were actually diminished by the sale of assets because the geographic scope of the covenant was reduced after the sale.[66] Thus, the court concluded that assignment was legal in this case.

The above cases demonstrate that Ohio has a much more lenient view towards assignability than Pennsylvania. The recurrent theme is that even if a contract clause is silent as to assignability, the non-compete clause can still be assigned to another company. However, Ohio courts will limit assignability in cases where the employee is burdened beyond the terms agreed upon in the original non-competition agreement when the contract is assigned. Thus, while Ohio is fairly lenient on assignability, the law is not without limits.

IV. CONCLUSION

Pennsylvania and Ohio have entirely different approaches to dealing with the assignability of covenants not to compete. While Pennsylvania has a fairly restrictive legal regime requiring a specific assignability provision or the consent of an employee for assignability to occur, Ohio courts have held that assignability can occur without a specific assignability clause or the consent of the employee. However, both states recognize that if the employee is burdened to a greater extent after assignability than previously, then the covenant may not be assigned. Despite the differences in approach, the most prudent course of action is to

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[63] *Id.* at 91, 786 N.E.2d at 917.
[64] *Id.* at 91, 786 N.E.2d at 918.
[65] *Id.* at 92, 786 N.E.2d at 919.
[66] *Id.* at 93, 786 N.E.2d at 919.

draft an employment contract that makes clear that the covenant not to compete is freely assignable by the employer.