

Insights

Indiana Blue Pencil Doctrine is More of a Blue Pen Doctrine as it Permits Courts to Strike through but not Erase Unenforceable Provisions in Restrictive Covenants

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Indiana employers striving for strong but enforceable competitive restraints on their employees have new guidance from the Indiana Supreme Court's decision in: *Heraeus Med., LLC v. Zimmer, Inc.*, No. 19S-PL-471, 2019 WL 6485087 (Ind. Dec. 3, 2019)

Kolbe initially worked as a regional group director for Zimmer, Inc., which manufactured and sold its own line of bone cements and also had a subsidiary (Zimmer Surgical) with exclusive rights to distribute bone cements manufactured by Heraeus Medical GmbH. Kolbe signed an agreement that included a non-compete and non-solicitation of Zimmer Surgical's customers and employees.

Kolbe quit after about two years' employment with Zimmer, Inc. and took a job as vice president of sales for a newly created company (Heraeus Medical, Inc.) that would sell the bone cements manufactured by Heraeus Medical GmbH. Heraeus Medical GmbH then terminated its distribution agreement with Zimmer Surgical. As Kolbe was now working for a direct competitor, Zimmer, Inc. sued to enforce the non-compete and non-solicitation agreement.

On appeal, the Indiana Court of Appeals applied the familiar analysis to determine enforceability of those restraints. The employer must show a "protectable business interest" by demonstrating that the employment relationship gave the former employee a unique competitive advantage or ability to hurt the employer competitively. The employer must also show that its contract was a reasonable means to protect that interest by demonstrating that the competitive restraints were reasonable as to geographic area, duration, and activities.

In its decision, the Court of Appeals found that the non-solicitation covenant for employees was overly broad because it prohibited Kolbe from soliciting "any individual employed by [Zimmer, Inc.]" when Kolbe's employment ended. The court found that the employer could have no legitimate protectable interest an entire workforce, which included persons such as drivers and shelf stockers. Employers cannot fairly restrict the mobility of employees at that level, who have no access to knowledge or customers that they could take to a competitor for an unfair advantage. To remedy the overly broad provision, the Court of Appeals used a reformation clause in the Agreement that authorized the Court to modify unenforceable provisions. In "blue penciling" the covenant to make it enforceable, the Court of Appeals "add[ed] language limiting the covenant's scope to only 'those employees in which [Zimmer] has a legitimate protectable interest.'"

Heraeus Medical, Inc., then petitioned for transfer to the Indiana Supreme Court. On transfer, the Indiana Supreme Court limited its review to whether an Indiana court can, with authorization from a reformation clause, "add language to an unenforceable restrictive covenant in a noncompetition agreement."

Scope of Blue Pencil Doctrine. The blue pencil doctrine allows a court to strike through or “sever unreasonable, divisible portions [of a restrictive covenant to] enforce[e] the reasonable parts that remain.” In general, Indiana courts apply the blue pencil doctrine strictly and are not authorized to “rewrite a noncompetition agreement by adding, changing, or rearranging terms.”

Effect of Reformation Clause. Here, the Agreement had a reformation clause that sought to expand the Court’s power beyond what the blue pencil doctrine prescribes to give courts “authority, if necessary, to reform any [unreasonable] provision to make it enforceable under applicable law.” However, the Supreme Court found that the limited scope of the blue pencil doctrine cannot be expanded or circumvented by the parties adding a “magic phrase” delegating provision drafting authority to the courts. Rather, reformation clauses may encourage courts to use the blue pencil doctrine but cannot authorize the courts to take the place of the parties and make guesses as to what the parties intended when the agreement was originally drafted.

Employee Non-Solicit. Turning to the employee non-solicitation covenant contained in Kolbe’s Agreement, the Supreme Court affirmed the Court of Appeals’ determination that the covenant was overly broad because it prohibited Kolbe from soliciting “any individual employed” by Zimmer, and was not limited to those employees who have “access to or possess any knowledge that would give a competitor an unfair advantage.” The Supreme Court attempted to blue pencil the clause by removing the “any individual employed” language but found it was indivisible as removing it would remove the subject of the non-solicitation clause. Therefore, the Supreme Court found that the non-solicitation could not be blue-penciled and the non-solicitation clause was therefore unenforceable.

Takeaways. *Heraeus Medical, LLC* reminds employers of the importance of careful drafting in employment agreements. Indiana courts “will not hesitate” to strike down overly broad competitive restraints. Employers must carefully craft agreements that protect legitimate competitive objectives but do not encroach on rights of employees to find gainful alternative employment or the rights of other businesses to hire qualified staff and compete fairly in the marketplace. Geographic restraints can be defined by reference to matters outside the agreement but should be drafted distinctly to avoid costly factual disputes to define the territory. Employers must judiciously define the co-workers who are off-limits to the former employee. And employers should take care in drafting the restrictive covenants as a “blue pencil” provision will only permit a court, at its discretion, to sever unreasonable portions and will not permit a court to rewrite or add terms to make an unreasonable covenant enforceable.