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Top Employers Know When To Seek Counsel

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Change in Kentucky Law Regarding Non-Compete Agreements

On June, 19, 2014, the Kentucky Supreme Court altered the state of the law with respect to covenants not to compete signed by employees in the case of Creech, Inc. v. Brown, et al., 2012-SC-000651 (Ky. 2014) ("Creech"). If you would like a copy of the decision, please let me know. Before Creech, Kentucky law was generally interpreted to allow employers to have employees sign non-compete agreements after employment had started (even years later) since "continued employment" was deemed sufficient consideration to make the agreement enforceable.

The primary case previously relied upon by employers for this proposition was Central Adjustment Bureau, Inc. v. Ingram Associates, Inc., 622 S.W.2d 681(Ky. App. 1981). In that case, 3 employees signed non-compete agreements after being hired. When they left employment years later, the Court enforced the agreements finding that even if there was no consideration when the non-competes were signed, there was when the employees resigned since they had acquired specialized knowledge, training and skills they would not have otherwise acquired and had received raises and promotions over the course of their employment. Thus, the non-competes were enforceable.

However, pursuant to the Creech case, the law in Kentucky has changed in that regard. The Kentucky Supreme Court has now limited Central Adjustment to its specific set of facts. In the recent case, a sales employee, who had worked for the employer for 16 years, was asked to sign a non-compete agreement. It was limited to a 3-year period and no geographic area was included. Shortly after the employee signed the agreement, his employer transferred him from his job as a salesperson to a dispatcher. His salary stayed the same but his responsibilities decreased and he had little or no customer contact. Two years later, the employee resigned and accepted a position with a competitor. A lawsuit was filed to enforce the non-compete agreement claiming that "continued employment" was sufficient consideration relying, in part, upon the Central Adjustment case. The Kentucky Supreme Court disagreed finding that the covenant not to compete was NOT enforceable due to lack of consideration. Therefore, the employee could properly work for a competitor.

On appeal, the employer argued that the Central Adjustment case, cited above, found that continued employment was sufficient consideration. However, the Court distinguished that case from the facts in Creech finding that in Central Adjustment, continued employment was not the only factor relied upon to find consideration for the non-compete agreement. Instead, there were at least 4 factors present to support consideration: (1) the non-competes were signed shortly after employment started (within 2 months); (2) all 3 employees continued to be employed for a number of years; (3) all 3 employees received raises and promotions while employed; and (4) the employees "acquired specialized knowledge, training, and expertise in the . . . business which they might not have had otherwise." To the contrary, in Creech, only one factor was present, continued employment. Thus, the Court held that the covenant not to compete was invalid and unenforceable since continued employment is not consideration for the agreement.

The other case relied upon by the employer in Creech to support enforceability of the non-compete agreement was Higdon Food Service, Inc. v. Walker, 641 S.W.2d 750(Ky. 1982) where the employee signed a non-compete agreement 4 years after beginning employment. However, the Court also found the Higdon case to be distinguishable because the employee therein signed an employment contract at the same time he signed the non-compete. Thus, he was no longer an at-will employee and gained certain rights to continued employment at that time. Since the new employment contract altered the nature of his relationship with the employer, Higdon was not dispositive of the case. Specifically, the employment contract created rights for the employee so that he could only be discharged if his work was unsatisfactory or no longer needed. Therefore, that was deemed sufficient consideration for the agreement. To the contrary, in Creech, there was no alteration of the employee's status so that he gained any new rights by the non-compete agreement. Likewise, the employer did not give up anything of value. Therefore, the facts in Higdon were much different than the facts in Creech. Accordingly, the Court would not uphold the non-compete agreement due to lack of consideration. Summary Judgment was reinstated for the employee and his new employer.

In Creech, the Court summarized the distinction in the two prior cases as follows:

> There is a common thread running through both Higdon and Central Adjustment—after the non-compete provision was signed, whether as part of a larger employment contract or as a stand-alone document, **the employment relationship between the parties changed.** In Higdon, the employee became more than simply an at-will employee. In Central Adjustment, the employees received specialized training as well as promotions and increased wages.

Therefore, the key factor analyzed by the Court, in deciding if there was consideration for the agreement, is how the relationship of the parties changed after signing the non-compete. Was any specialized training provided? Was a raise given? Was the employee promoted? Did the employee gain certain rights or expectations in continued employment or did they continue to be "at will"? If not, then pursuant to the Creech case, the agreement may not be enforceable due to lack of consideration.

Employers' Bottom Line

-Based on Creech, get non-compete agreements signed when employment begins or shortly thereafter. Do not wait several years later to put non-competes in place. This will generally provide a stronger basis to seek enforcement of the agreements, if needed.

-Take a look at existing non-compete agreements. If employees have signed non-compete agreements several years after employment started, please review each situation carefully to see if adequate consideration is present. Seek legal counsel, as needed, to address concerns. During your review, ask whether the employment relationship changed after signing the agreement. Examples of changes that may provide consideration include: access to proprietary information, specialized training or knowledge, raises or promotions, or restrictions on the ability to terminate employment. Remember that under Creech, continued employment alone may not be sufficient consideration.

-If you plan to have non-compete agreements signed after employment begins, then proceed with caution. Seek legal counsel so that steps can be taken to analyze whether sufficient consideration is present for the enforceability of the agreements.

-The Creech Court also pointed out that the employer did not make signing the non-compete a condition of continued employment when presented to the employee. Therefore, always make signing the agreement a condition of continued employment.

-The agreement at issue in Creech lacked a geographic restriction. Non-competes should always include restrictions that are limited in duration and geographic scope and both restrictions must be reasonable.

For additional information on Employment or Labor Law issues, please contact TAMMY MEADE ENSSLIN at 859-368-8747.