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Commonwealth of Kentucky

Court of Appeals

NO. 2011-CA-000629-MR

CHARLES T. CREECH INCORPORATED — APPELLANT

v.

APPEAL FROM FAYETTE CIRCUIT COURT
HONORABLE KIMBERLY N. BUNNELL, JUDGE
ACTION NO. 09-CI-00779

DONALD E. BROWN; AND
STANDLEE HAY COMPANY, INC. — APPELLEES

OPINION
REVERSING AND REMANDING

** ** ** ** **

BEFORE: ACREE, CHIEF JUDGE; MOORE AND VANMETER, JUDGES.

ACREE, CHIEF JUDGE: This case involves a noncompetition agreement executed by Donald E. Brown while he was an employee of Charles T. Creech, Inc. He later left his employment with Creech, Inc. to work for Standlee Hay Company, Inc., an act Creech, Inc. contends constituted breach of the agreement.

Following preliminary proceedings, the Fayette Circuit Court entered summary judgment in favor of Brown and Standlee Hay on Creech, Inc.'s claims that Brown breached contracts incident to his employment, that Standlee Hay illegally interfered with Brown's employment-related contracts and the conduct of Creech, Inc.'s business, and that both defendants committed fraud. We conclude that Creech, Inc. was entitled to additional discovery to resolve the dispute and entry of summary judgment was premature.[1]

I. Facts and procedure

Charles T. Creech, Inc. is a Lexington, Kentucky-based provider of hay and straw servicing customers in Kentucky, Ohio, New York, other unspecified locations in the United States, and overseas. Standlee Hay is a grower of hay whose operation is headquartered in Idaho; it sells the hay it grows in addition to hay it purchases from other suppliers. Our review of the record has not revealed the full geographic scope of Standlee Hay's operations, but its business

[1] Creech, Inc. also asserted in its complaint that Brown had breached the employment agreement by violating a clause which prohibited the disclosure of the employer's "proprietary" information. However, Creech, Inc. made no mention of the nondisclosure clause in its initial appellant's brief. While Standlee Hay and Brown, in their appellees' briefs, did contend summary judgment was properly entered on the basis of the purported nondisclosure agreement, such mention does not preserve or raise the issue for Creech, Inc. as grounds for *reversing* the summary judgment. Creech, Inc.'s first mention of the issue is in the final paragraphs of its reply brief. Furthermore, nowhere does Creech, Inc. include a statement of preservation of the error as required by Kentucky Rule of Civil Procedure (CR) 76.12. Therefore, there is no need to address this argument. *Catron v. Citizens Union Bank*, 229 S.W.3d 54, 59 (Ky. App. 2006) (Declining to consider an argument of the appellant because "Catron has not shown where and in what manner this argument was preserved for appeal. Furthermore, he raises it for the first time in his reply brief.").

Our holding will consequently affect only Creech, Inc.'s claim of breach of the covenant not to compete and the other claims arising therefrom. Summary judgment on the alleged breach of the nondisclosure provision is not disturbed, and neither is entry of summary judgment on any of the remaining claims to the extent those claims are premised on breach of the nondisclosure agreement.

unquestionably extends into Kentucky. Both businesses sell and distribute their product primarily to horse farms. Charles T. Creech is the president of Creech, Inc., and Mike Standlee is the president of Standlee Hay; both presidents are members of the Kentucky Thoroughbred Farm Managers' Club.

After already having spent nearly two decades working in the industry in undisclosed capacities, Brown began employment with Creech, Inc. in 1990. Over the course of his eighteen-year employment with Creech, Inc., he served as a delivery driver, a salesman, and a dispatcher. In 2006, while Brown was acting as a salesman, officials of Creech, Inc. asked him to sign a document entitled "Conflicts of Interest." In addition to prohibitions against employee behavior which might conflict with the employer's business interests, this document contained a provision relevant to the instant dispute, the noncompetition clause. That portion of the agreement provided:

> The industries that Creech, Inc. operates within are highly competitive. We require that all employees agree and understand that after leaving the company they are not permitted to work for any other company that directly or indirectly competes with the company for 3 years after leaving Creech, Inc. without the companies [sic] consent.

The document also included the following admonition:

> Failure to comply with this policy during employment may result in immediate termination. In the event an employee or former employee violates this policy, the company will prosecute to the fullest extent of the law, including the recoup [sic] of legal expenses incurred during such prosecution, if it deems that its interests were not protected or appropriately respected by any of its employees.

Brown would continue his employment with Creech, Inc. for just over two more years. Approximately eight months after executing the agreement, Brown was reassigned to a dispatcher position. His salary did not change appreciably.

In 2008, Brown left employment with Creech, Inc. for a position with Standlee Hay which would require, among other duties, that he act as a salesman to potential customers in Kentucky. Creech, Inc. executed a limited waiver of the noncompetition clause, permitting Brown to be employed by Standlee Hay without breaching the agreement, so long as he did not assist his new employer in business pursuits which directly or indirectly competed with those of Creech, Inc. Creech, Inc. now contends this waiver was based upon false information provided by Brown and Standlee Hay.

After receiving the waiver, Standlee Hay notified Creech, Inc. that Brown would be conducting business on behalf of Standlee Hay in Kentucky and, necessarily, would be required to contact Creech, Inc.'s past and current clients. Neither Brown nor his new employer received any response from Creech, Inc., and Brown proceeded with his new job.

Believing that Brown had breached the noncompetition clause and that by employing Brown Standlee Hay was improperly interfering with its business operations, Creech, Inc. filed suit in Fayette Circuit Court. The circuit court entered a temporary injunction against Brown and Standlee Hay, prohibiting Brown from conducting business in Kentucky on Standlee Hay's behalf. Brown

and Standlee Hay sought relief from the injunction from this Court pursuant to CR 65.07, and relief was granted. In so doing, the Court made several statements about the merits of the underlying issues. Those statements suggested Creech, Inc.'s claims must fail.

On remand, and understandably believing the CR 65.07 order made it clear Creech, Inc. could not succeed on the merits, the circuit court entered summary judgment in favor of Brown and Standlee Hay. The order of summary judgment included no findings of fact or conclusions of law, neither of which is required under CR 52.01. This appeal followed.

II. Standard of review

CR 56 authorizes a trial court to enter summary judgment when the evidence "show[s] that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law." CR 56.03. In considering a motion for summary judgment, the trial court must view the evidence in the light most favorable to the nonmoving party and may enter summary judgment only if it appears impossible for the nonmovant to prevail. *Steelvest, Inc. v. Scansteel Serv. Ctr, Inc.*, 807 S.W.2d 476, 480, 482 (Ky. 1991). Furthermore, "[b]ecause summary judgment involves only legal questions and the existence of any disputed material issues of fact, an appellate court need not defer to the trial court's decision and will review the issue de novo." *Lewis v. B & R Corp.*, 56 S.W.3d 432, 436 (Ky. App. 2001) (footnote omitted).

III. A word about injunctive relief

Before turning to the Discussion portion of this opinion, we must take a brief detour to discuss a matter of procedure which has come to dominate this case. That matter is this Court's order requiring dissolution of the injunction. Both parties have expended considerable energy arguing about the effect the order should or should not have in this appeal. The appellees believe it is controlling; Brown even contends it should be deemed law of the case. Creech, Inc. disputes that it is binding and notes the inquiry before the motions panel was limited to the propriety of issuing a temporary injunction.

Whatever effect it may have had on the parties and the circuit court prior to this appeal, the order mandating dissolution of the injunction is interlocutory and therefore nonbinding on the merits. CR 65.07; *Progress Laundry Co. v. Hamilton*, 208 Ky. 348, 270 S.W. 834, 937 (1925) (stating a previous ruling on an injunction is not binding, but is persuasive and will be followed if its reasoning is found to be sound). It was entered as a result of an interlocutory appeal and on the basis of a limited record. CR 65.07(3). It has the same status as other interlocutory orders in that it may be changed at any time prior to the finality of the action. *Wilson v. Russell*, 162 S.W.3d 911, 913 (Ky. 2005). The law of the case doctrine does not apply to interlocutory orders, so this Court is not bound by its previous order. *Watkins v. Pinkston*, 190 Ky. 455, 227 S.W. 583 (1921).

We now turn to our review of the entry of summary judgment in favor of Brown and Standlee Hay.

IV. Discussion

Creech, Inc. argues the circuit court erred in entering summary judgment with respect to its claim that Brown breached the noncompetition agreement and the other claims which arose from that alleged breach. To that end, Creech, Inc. maintains the agreement was supported by valid consideration and that its terms are reasonable; Creech, Inc. also contends that if the agreement was fatally lacking in a reasonable geographic limitation, the circuit court was empowered to establish such a limitation. The appellant further believes that additional discovery was warranted.

The appellees counter that the agreement's restriction on Brown's future employment is invalid because its terms were unreasonable and because it lacked consideration. They also assert the circuit court did not possess the authority to insert a reasonable geographical limitation into the agreement and that Creech, Inc. waived any rights it did secure under the contract.

A. Reasonableness and validity of the noncompetition agreement

Both parties point to certain of their factual circumstances which they believe are dispositive of the question whether the covenant not to compete is valid and enforceable because its terms are reasonable. The proper inquiry, however, is more complex than either party would have us believe.

It is tempting in disputes concerning noncompetition agreements to turn to existing case law in search of a single guiding principle, or perhaps a collection of hard-and-fast rules which determine the validity of any given covenant not to compete. In fact, very few bright-line rules govern the inquiry now before us.

For example, the parties argue strenuously in their briefs about whether a trial court can insert reasonable geographical restrictions into a noncompetition agreement which contains no such restrictions at all. The general rule that covenants not to compete "are not enforceable where they are . . . unlimited as to space but limited as to time," in the context of employment contracts has never been explicitly overturned;[2] however, this Court has arguably determined that the "blue pencil rule," extends to all provisions of a noncompetition agreement.[3] *Kegel v. Tillotson*, 297 S.W.3d 908, 913 (Ky. App. 2009) ("[O]ur courts have adopted a 'blue pencil' rule, whereby we are empowered to reform or amend restrictions in a non-compete clause if the initial restrictions are overly broad or burdensome."). But mere recitation of these general rules or others does not

[2] *But see Hodges v. Todd*, in which this Court held "that the trial court had the authority to enforce [a noncompetition] covenant [which wholly omitted a geographical limitation] by establishing a reasonable geographical limitation based on the intention of the parties at the time the contract was executed. 698 S.W.2d 317, 319 (Ky. App. 1985). *Hodges* admittedly addressed only those noncompetition agreements which were part of a contract for sale of a business. However, given the persistent tendency of Kentucky courts to apply rules governing noncompetition agreements in contracts for the sale of business to those included in employment contracts, and *vice versa*, we believe it likely that the old rule that employment contracts whose covenants not to compete fail to state a geographic limitation are invalid is probably no longer the law.

[3] The conceptual use of a "blue pencil" was first mentioned in Kentucky jurisprudence in *Reed v. Reed*, 457 S.W.2d 4, 18 (Ky. 1969), where it was said that courts "have no right to take a blue pencil to the compiled acts of the legislature and strike therefrom those acts which do not suit our fancy[.]" The colloquialism was then applied to criminal plea agreements in *O'Neil v. Commonwealth*, 114 S.W.3d 860, 864 (Ky. App. 2003)(A defendant must withdraw from or abide by a plea agreement in its entirety. "It is inappropriate to take a blue pencil to the agreement, removing the provisions that in retrospect the defendant wishes were not there." Citations omitted). Its next reference was in *Kegel*.

resolve the dispute, and there is no single Kentucky case which is so like this one that it cannot be distinguished in some meaningful way.

Despite the lack of universally applicable rules, some guiding principles are clear. First, as noted in *Kegel*, trial courts are empowered to modify unreasonable provisions of covenants not to compete, and doing so will save an agreement which might otherwise be unenforceable. 297 S.W.3d at 913; *Hammons v. Big Sandy Claims Serv., Inc.,* 567 S.W.2d 313, 315 (Ky. App. 1978).

Furthermore, the circuit court's inquiry into the reasonableness of a covenant not to compete is guided by the following principle:

> an agreement in restraint of trade is reasonable if, on consideration of the subject, nature of the business, situation of the parties[,] and circumstances of the particular case, the restriction is such only as to afford fair protection to the interests of the [employer] and is not so large as to interfere with the public interests or impose undue hardship on the party restricted [the employee].

Hammons, 567 S.W.2d at 315 (applying the principles articulated in *Ceresia v. Mitchell*, 242 S.W.2d 359 (Ky. 1951) to its analysis of a noncompetition clause of an employment contract). Inherent in this rule is a need for case-specific flexibility. The reason is that the factual circumstances of a covenant not to compete will necessarily vary from industry to industry, from employer to employer, and from region to region. Attempting to erect a set of bright-line rules to govern courts' treatments of these agreements would be futile and counterproductive.

The proper approach to the rule articulated in *Hammons* and elsewhere can be reduced to a series of factors which should be considered in nearly every case.[4] They are: (1) the nature of the industry; (2) the relevant characteristics of the employer; (3) the history of the employment relationship; (4) the interests the employer can reasonably expect to protect by execution of the noncompetition agreement; (5) the degree of hardship the agreement imposes upon the employee, in particular the extent to which it hampers the employee's ability to earn a living; and (6) the effect the agreement has on the public. Each factor requires some discussion.

The nature of the industry: In examining this factor, the trial court should determine whether the industry in which the employer is engaged, and in which the employee desires to continue working, is highly competitive. Is there a limited opportunity to participate in this industry? How many players are there in the market, and are their respective market shares relatively large or small? *Central Adjustment Bureau, Inc. v. Ingram Assocs., Inc.*, 622 S.W.2d 681, 685-86 (Ky. App. 1981). Is there a history of competitors trying to gain knowledge of one another's data or methods in an effort to gain a competitive advantage? *See id.* Is there a history of "poaching" competitors' employees so as to eradicate competition? *Higdon Food Servs. v. Walker,* 641 S.W.2d 750, 752 (Ky. 1982). Does each employer develop its own competitive strategy, business model, or technology which determines how successful that particular competitor will be?

[4] This opinion is not the first to recognize or apply these factors, but only the first to express them together in this manner.

See Central Adjustment Bureau, 622 S.W.2d at 681. Or are all the competitors succeeding primarily according to their own skills which are not kept confidential or secret, including their reliability, people skills, reputation, competitive prices, and good service?[5] *Id.; Hammons,* 567 S.W.2d at 315.

Characteristics of the employer: The trial court should seek to determine who the employer is in the context of the industry and the geographical region. *Central Adjustment Bureau,* 622 S.W.2d at 686. What is the scope of the employer's operations, both in terms of geographic reach and number of customers serviced or products distributed? How many employees work for the employer? What roles do those employees play in the company and to what type of information are they exposed? *Id.*; *Hammons,* 567 S.W.2d at 315. What is the employer's status in the industry and what share of the market does it serve?

The history of the relationship between the employer and employee: This factor will help determine the fairness of the employer's insistence that the employee enter the covenant not to compete. When, relative to the onset of the employment relationship and the end of the employment relationship, was the agreement signed? *Id.*; *see also Crowell v. Woodruff,* 245 S.W.2d 447, 450 (Ky. 1951) ("There must be read into the contract an implied obligation to retain [the employee] in the employment such period of time as would deserve the right to

[5] Not all of the categories or all questions within a category which are identified in this portion of the discussion must be addressed in every inquiry; our list of factual circumstances which may bear on each factor is neither mandatory nor exhaustive. Rather, as we stated before, the trial court's approach must be flexible depending on the parties and their circumstances.

enforce the obligation he assumed not to enter other employment for a year.").[6] Did the employee arrive on the job with all the skills he needed to do the work required by the employer, or did the employer have to specially train and develop certain skills which would be of special value to the employer? *Central Adjustment Bureau,* 622 S.W.2d at 686.

The interests the employer seeks to protect: This portion of the inquiry should focus on whether the employee's subsequent hiring by a competitor of the employer would essentially deprive the employer of its competitive position. Or, rather, would it be no different than if the competitor had hired an employee from another competitor in the market? In other words, would the employee's departure – and subsequent employment by a competitor – necessarily cause the employer's own innovation or distinctive approach to its business to be used against it to its detriment?

An important part of this inquiry is whether the agreement is narrowly tailored to protect its interests. *Crowell*, 245 S.W.2d at 449 (a "test of reasonableness [is] whether … the restraint imposed upon the employee … is more comprehensive than is necessary to afford fair protection to the legitimate interests of the employer … [.]") (citations omitted).

[6] To be clear, the proper focus in a reasonableness analysis is not whether the agreement was supported by consideration (the consideration often being continued employment), which requires a different and perhaps simpler inquiry, but about the fairness of requiring an employee to enter into such an agreement; if the employee appears to have been coerced, there is a strong argument that it is unreasonable and unenforceable.

Hardship on the employee: For this inquiry, the court should look to the specific limitations of the agreement – what spatial, temporal, and employment restrictions are there on the employee's ability to work, and what is their impact on the employee? Obviously, the broader the restriction, the greater the burden will be. A trial court might inquire how long the employee has worked in the industry, both for the employer and for others. How likely is it that the employee will be able to find gainful employment if he complies with the covenant's restrictions? Will enforcing the covenant effectively compel the employee to part with his education and experience to find employment in a new sector? *See Crowell,* 245 S.W.2d at 449-50. In sum, the court should determine whether the restrictions on future employment intended to protect the employer's interests are not so broad as to unduly burden the employee's ability to find work. Where the restrictions on future employment are narrowly tailored to meet the employer's needs, they should typically be enforced. *See, e.g., Hammons*, 567 S.W.2d at 315 (A covenant not to compete was reasonable where it did not prevent the subject employee from working in the employer's industry, but only prohibited him from going into business for himself in that industry for one year.).

This is also the point in the analysis where the trial court may modify certain provisions of the noncompetition agreement if doing so would not work an injustice upon the parties, if a modification would make the agreement reasonable, and if the court determines in its discretion that it is wise to do so. *See*, *Kegel*, 297 S.W.3d at 913.

Impact on the public: Finally, the trial court must assess how, if at all, enforcement of the covenant will affect the public. Does the covenant restrict the public's access to the types of goods or services offered by the employer? Are the consequences and extent of that restriction acceptable given the nature of the service provided by the employer and the needs of the community? *Hall v. Willard & Woolsey, P.S.C.*, 471 S.W.2d 316, 318 (Ky. 1971)("[T]he health of the public is better served if squabbles among physicians are averted by prior agreements and the public is not a pawn in the squabble.") ; *Central Adjustment Bureau*, 622 S.W.2d at 686.

Our review of the record reveals that the evidence before the circuit court was insufficiently developed to resolve all of the factors listed above, and indeed to answer the question whether, "on consideration of the subject, nature of the business, situation of the parties[,] and circumstances of the particular case," the noncompetition clause now at issue "is such only as to afford fair protection to the interests of the [employer] and . . . not so large as to interfere with the public interests or impose undue hardship on the party restricted." *Hammons,* 567 S.W.2d at 315.

We must therefore reverse the summary judgment order as prematurely issued and remand the matter to give the parties the opportunity to put forth sufficient proof for proper resolution of the case under this analysis.

B. Sufficiency of consideration

To the extent the entry of summary judgment may have been premised upon the court's conclusion that the noncompetition agreement lacked consideration, we also reverse.[7] It is undisputed that Brown continued his employment with Creech, Inc. for more than two years after he signed the Conflicts of Interest document and that he departed the company voluntarily. There are four distinct schools of thought about whether continued employment, in and of itself, is sufficient consideration to enforce the noncompetition agreement. *McGough v. Nalco Co*., 496 F.Supp.2d 729, 745-46 (N.D.W.Va. 2007). However, "the courts of Kentucky and those applying Kentucky law found that employer-employee agreements may be executed in exchange for merely retaining one's job." *Dunn v. Gordon Food Serv., Inc.*, 780 F.Supp.2d 570, 574 (W.D.Ky. 2011) (citing *Higdon Food Servs., Inc. v. Walker*, 641 S.W.2d 750 (Ky. 1982)). The case so holding, *Higdon Food Services*, has been strongly criticized. J. Leibman and R. Nathan, *The Enforceability of Post-Employment Noncompetition Agreements Formed After*

[7] We choose to address these issues out of an abundance of caution. It is not apparent from the judgment whether either of these matters formed the basis of the order.

At-Will Employment Has Commenced: The 'Afterthought' Agreement, 60 S. Cal. L. Rev. 1465, 1533-34 (September 1987).[8] Nevertheless, it remains precedent that this Court lacks authority to change. Therefore, applying this precedent to the undisputed material facts, we conclude as a matter of law that the agreement was supported by sufficient consideration.

C. Questions of fact remain regarding the waiver issue

We turn now to the possibility that summary judgment was entered on a finding that Creech, Inc. waived its rights under the covenant not to compete.[9] The heart of the issue is this: Standlee Hay and Brown contend that in executing the

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[8] Leibman's and Nathan's critique of *Higdon Food Services* is as follows:

> The rescission theory is the notion that 'the first agreement is rescinded by the second, and being rescinded, each party, freed from previous obligations, may enter into the new agreement.' This theory is rejected by virtually all scholarly commentary as a mechanism for avoiding the preexisting duty rule. Nevertheless, at least one state has apparently adopted it to avoid the past consideration doctrine. In *Higdon Food Service, Inc. v. Walker*, Higdon hired Walker in 1974 under an oral agreement as an at-will employee. In 1978, Walker signed a written employment agreement containing a noncompetition covenant. In explaining why no new consideration was needed to support this later written agreement, the Kentucky Supreme Court stated: 'In the first place, whatever may have been the employment arrangement before, it was succeeded and superseded by the contract. In this sense it was the same as a new employment.'
>
> It certainly must have been an odd experience for Walker to read the Kentucky Supreme Court's opinion and to realize that in 1978 (4 years after his job commenced) he was 'a new employee' for Higdon. Judicial credibility is not advanced by such legal fictions. But as in so many cases cited already, the Higdon court was unwilling to explicitly rest its holding on anything other than a fictitious bargain which was further fictionalized through the rescission theory.

Leibman and Nathan, *supra*, at 1533-34 (footnotes omitted).

[9] *See* footnote 7.

limited waiver, and then taking no additional action when it became clear Brown's employment with Standlee Hay would exceed the boundaries of that waiver, Creech, Inc. fully waived its right to enforce the noncompetition agreement. Creech, Inc. disagrees that it was required to take any further steps to protect its interests under the agreement and further contends the written waiver was invalid because it was procured by a fraud perpetrated by both Brown and Standlee Hay.

"The common definition of a legal waiver is that it is a voluntary and intentional surrender or relinquishment of a known right, or an election to forego an advantage which the party at his option might have demanded or insisted upon." *Greathouse v. Shreve*, 891 S.W.2d 387, 390 (Ky. 1995) (quoting *Barker v. Stearns Coal & Lumber Co.,* 291 Ky. 184, 163 S.W.2d 466, 470 (1942)). Whether Creech, Inc. intentionally waived any or all of its rights under the agreement is a question of fact, and summary judgment was therefore improper on the basis of waiver. *Insurance Co. of N. Am. v. Forwood, Orths,* 13 Ky.L.Reptr. 261 (Ky. Super. Feb. 18, 1891) ("where the evidence upon this point is conflicting, waiver is a question of fact to be submitted to the jury.").

Genuine issues of material fact regarding waiver remain. Therefore, to the extent summary judgment was premised upon the implicit holding that Creech, Inc. waived its right to enforce the agreement, the judgment is reversed for additional discovery.

V. Conclusion

The entry of summary judgment in favor of Brown and Standlee Hay is reversed. We remand this matter to the circuit court for further proceedings not inconsistent with this opinion.

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