COMMONWEALTH OF KENTUCKY
KENTUCKY SUPREME COURT
NO. 2012–SC-000693

CHARLES T. CREECH, INCORPORATED — APPELLEE

v.

APPEAL FROM KENTUCKY COURT OF APPEALS
CASE NO. 2011-CA-000629-MR
and
APPEAL FROM FAYETTE CIRCUIT COURT
ACTION NO. 09-CI-000779

DONALD E. BROWN and
STANDLEE HAY COMPANY, INCORPORATED — APPELLANTS

JOINT REPLY BRIEF OF APPELLANTS, DONALD E. BROWN AND STANDLEE HAY COMPANY, INCORPORATED

CERTIFICATE OF SERVICE

The undersigned does hereby certify that copies of this Joint Reply Brief were served upon the following named individuals by U.S. Mail, postage pre-paid, on this the 29th day of August, 2013: Hon. Kimberly N. Bunnell, Fayette Circuit Court Judge, 521 Robert F. Stephens Courthouse, 120 N. Limestone, Lexington, KY 40507; Vincent Riggs, Fayette Circuit Court Clerk, 103 Robert F. Stephens Courthouse, 120 North Limestone, Lexington, KY 40507; Sam Givens, Clerk, Court of Appeals, 360 Democrat Drive, Frankfort, Kentucky 40601; Hon. Carroll M. Redford, Hon. Don A. Pisacano and Hon. Elizabeth C. Woodford, Miller, Griffin & Marks, P.S.C., 271 West Short Street, Suite 600, Lexington, KY 40507, and by hand-delivery to: Susan Stokley Clary, Clerk, Kentucky Supreme Court, 700 Capitol Ave., Frankfort, KY 40601.

The undersigned does also certify pursuant to CR 76.12(6) that the record on appeal was not withdrawn by the undersigned, or by the party filing this brief.

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STATEMENT OF POINTS AND AUTHORITIES

INTRODUCTION

The premise of this case is simple. Appellee seeks to enforce a COI Agreement against Appellants which is legally deficient under established Kentucky law.[1] The COI Agreement constitutes an unreasonable restraint on trade because it fails to provide any type of geographic scope whatsoever. This is fatal under Kentucky law. While Kentucky recognizes use of the "blue-pencil rule," this rule does not authorize Kentucky Courts to insert material terms into a contract which never existed in the first place. Moreover, enforcement of an undefined, open-ended restraint on trade is inequitable and against public policy. No amount of fact discovery can rescue the COI Agreement or the Appellee. The COI Agreement is unenforceable under Kentucky law and should be declared null and void. Accordingly, the CTA 8/17/12 Order should be reversed and Appellee's claims against Appellants dismissed.

ARGUMENT

I. THE COI AGREEMENT IS LEGALLY DEFICIENT AND UNENFORCEABLE PURSUANT TO KENTUCKY LAW

When determining the enforceability of the COI Agreement, this Court need look no further than Kentucky law. Legal precedent regarding the enforcement of non-compete agreements in Kentucky is well-established and has not been overruled. A valid and enforceable non-compete agreement must contain, among other things, a specific, reasonable geographic scope and must be supported by sufficient consideration. The absence of either of these requirements renders the non-compete agreement unenforceable.

A. Enforcement of Non-Compete Provisions in Employment Agreements

Kentucky Courts have long-recognized the critical distinction between enforcement of non-compete agreements in the context of the sale of a business and in an employer-employee

[1] All capitalized terms contained herein have been defined in Appellants' original Joint Brief of Appellants and shall have the same meaning as previously set forth therein.

relationship. As this Court is aware, "[c]ontracts in restraint of employment or personal services are not favorites of the law..." *Calhoun v. Everman*, Ky., 242 S.W.2d 100, 103 (1951). In fact, covenants not to compete are valid and enforceable only if "the terms of such covenants are reasonable in the light of the surrounding circumstances." *Crowell v. Woodruff*, Ky., 245 S.W.2d 447, 449 (1951). "Reasonableness is to be determined generally by the nature of the business or profession and employment, and the scope of the restrictions with respect to their character, duration, and territorial extent." *Id.*

However, in gauging reasonableness, "there is a distinction between a covenant ancillary to the sale of a business and to a contract of employment." *Id.*at 449; *see also Hodges v. Todd*, Ky.App., 698 S.W.2d 317, 319 (1985). In *Woodruff, supra,* the Court stated "[l]et it be borne in mind that covenants restrictive of future employment are not viewed with the same indulgences as those between a vendor and a vendee of a business..." *Id.* at 450. Thus, covenants not to compete in the context of an employer-employee relationship are scrutinized more closely and held to a stricter standard than those pertaining to the sale of a business. This distinction is even recognized by Appellee in its Brief. (Appellee's Brief, p. 13). Accordingly, Appellee's reliance on case law involving non-compete agreements in the context of a sale of a business is not controlling with regard to the validity of the COI Agreement at issue in the present case.

In Kentucky, "[t]he general rule is that contracts in restraint of trade are not enforceable where they are unlimited as to both time and space, or as to where they are unlimited as to space but limited as to time." *Calhoun v. Everman*, Ky., 242 S.W.2d 100, 102 (1951). A non-compete agreement which does not contain a geographic scope is invalid and unenforceable in Kentucky. As is recognized in the CTA 8/17/12 Order, this rule of law has not been overruled or overturned. (See CTA 8.17.12 Order, p. 8, attached as **App.Item 6** to Appellant's Brief). It is

still binding legal precedent and must be followed. The lack of geographic scope in the COI Agreement is fatal to its validity and enforceability. This deficiency is dispositive under Kentucky law and the Court's analysis need go no further.

B. Application of the "Blue-Pencil Rule"

Despite the clear lack of geographic scope in the COI Agreement, Appellee maintains that the Court is authorized to **insert** a geographic limitation where none previously existed. Appellee argues that Kentucky Courts have the authority to "modify" an otherwise invalid contract in order to make it enforceable. Specifically, Appellee relies on application of the "blue-pencil rule" and **its** interpretation of how this rule should be applied in the present case.

Much has been said by both parties about the "blue-pencil rule" and its present-day application/status. Generally, the "blue-pencil rule" provides that if unreasonable provisions exist in a contract, they may be stricken, if devisable, but not amended or modified. *Raimonde v. Van Vlerah*, 325 N.E.2d 544, 546 (1975). It further provides that if restrictions are unreasonable and indivisible, the entire contract fails. *Id.* Typically, this rule only applies in the context of a provision that includes both an unreasonable restraint on trade and another narrower, reasonable restraint, which are divisible from one another and where the unreasonable portion may be stricken with the blue pencil. 54 Am.Jur.2d Monopolies and Restraints of Trade, Sec. 963. Blue-pencil rule. The intent being that what remains after use of the "blue-pencil" is a reasonable, enforceable provision which was already contemplated by the parties and which already appeared in the agreement prior to application of the rule.

Appellee argues that this rule has evolved with modern case law to allow/authorize Kentucky Courts to "modify" an otherwise unreasonable, unenforceable provision in order to make it reasonable in scope. Appellee relies on *Kegel v. Tillotson*, Ky.App., 297 S.W.3d 908

(2009) in support of its position. However, *Kegel* is clearly distinguishable from the present case.

Appellee references certain language at the end of the Court's opinion which comments on a court's ability to "reform or amend restrictions in a non-compete clause if the initial restrictions are overly broad." *Kegel*, 297 S.W.3d at 913. Despite Appellee's claims to the contrary, this language was simply not part of the Court's holding. The *Kegel* Court, in addressing the validity of the subject non-compete agreement, held that such agreements were assignable and that the lower court had prematurely entered judgment on the issue of unconscionability. *Id.* The Court remanded the matter back to the lower court for further discovery and consideration. *Id.* The *Kegel* Court made no holding as to the enforceability of the subject non-compete agreement, nor did it require the lower court to reform the agreement.

Moreover, regardless of whether the language relied upon by Appellee is considered to be dicta or part of the Court's underlying holding, one key factor distinguishes *Kegel* from the instant case. In *Kegel*, there was a specific geographic scope contained in the non-compete provision at issue which provided that "the Contractor...shall not engage in the business of marketing, selling or taking orders...in the territory that the Owner sells merchandise, which is an area of at least three hundred fifty (350) mile radius from the Owner's business address, for five (5) years." *Id.* at 910.

In contrast, the non-compete provision drafted by Appellee in the present case does not contain **any** type of geographic scope at all. It simply provides that its employees "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." (See COI Agreement, attached as **App.Item 1** to Appellant's Brief). Thus, there is clearly no geographic

scope to the COI Agreement. Furthermore, the transaction at issue in *Kegel* was more akin to a sale of a business than that of a direct employer-employee relationship.

Appellee also relies on *Ceresia v. Mitchell*, Ky., 242 S.W.2d 359 (1951) for the proposition that the "blue-pencil rule" may be used to modify an unreasonable, unenforceable non-compete provision in an employer-employee context. Appellee contends that *Kegel* reaffirmed the holding in *Ceresia* and references the phrase "the best considered modern cases." However, *Ceresia* provides, in pertinent part, as follows:

> In a good many cases it was held that if the contract itself indicated no geographical line between the reasonable and the unreasonable, it was "indivisible" and illegal as a whole. Thus, if a seller promised not to compete anywhere in England the whole was void, but if he promised not to compete in London or elsewhere in England, partial enforcement was possible in case the business had extended throughout London.
>
> In very many cases the courts have held the whole contract to be illegal and void where the restraint imposed as in excess of what was reasonable and the terms of the agreement indicated no line of division. In the best considered modern cases, however, the court has decreed enforcement as against a defendant whose breach has occurred within an area in which restriction would clearly be reasonable, **even though the terms of the agreement imposed a larger and unreasonable restraint**...

[Emphasis added]. *Id.* at 362-363 (citing Corbin on Contracts, Vol. 6, Section 1390, pp. 499-502, West Publishing Company (1951)). The *Ceresia* Court, in the context of the sale of a business, determined that an unreasonably broad, **already existing** geographic scope could be modified by reducing that scope to a more limited, reasonable area.

Ceresia involved the sale of a business rather than an employment agreement. Moreover, the *Ceresia* Court confined the already existing geographical scope from "the County of Muhlenberg and the State of Kentucky" to Central City and Muhlenberg County. *Id.* at 362. The Court simply modified the already existing geographic limitation to make it more reasonable. This type of "modification" is significantly different from what the Appellee seeks

in the present case, which is for this Court to sanction a wholesale reformation of the COI Agreement.

Appellee asks the Court to insert a geographic limitation where none previously existed. This is not a "modification" of existing terms, but creation of a new term which was not negotiated and agreed upon by the parties. Thus, even assuming *arguendo* that *Kegel* and *Ceseria* provided Kentucky Courts with the authority to modify an already existing geographic scope to make it reasonable, this provides Appellee with no relief in the present case. There is not an already existing geographical limitation in the COI Agreement. Thus, there is nothing to modify.

In order to provide Appellee with the relief requested, the Court would have to create and insert a material term into the COI Agreement. This is not permitted under even the most basic of contract construction principles.

In Kentucky, contract construction is a question of law to be decided by the court. *Commonwealth Bank of Prestonsburg v. West*, Ky.App., 55 S.W.3d 829, 835 (2000). In order to constitute a valid and enforceable contract, "the material terms of the contract must be established with sufficient definiteness and certainty." *Rumell v. Barden & Robeson Corporation*, 2007 WL 4277890, p. 2 (Ky.App). "The court may not make complete for the parties a contract which they have left incomplete and uncertain in its material terms." *Tharp University School v. Komus Realty Co.*, Ky., 167 S.W. 136, 137 (1914). Moreover, when interpreting a contract, it is to be construed strongest against the party who drafted and prepared it. *Perini & Sons, Inc. v. Southern Ry. Co.*, Ky., 239 S.W.2d 964, 966 (1951).

The construction of non-compete agreements are subject to these same rules. Moreover, geographic scope is clearly a material term to a non-compete agreement in the employer-

employee context. As such, the COI Agreement is not sufficiently definite or certain as it lacks any geographic scope. It is incomplete and uncertain in its material terms and the Court is not authorized or permitted to insert such a material term where none previously existed. The COI Agreement is legally deficient and unenforceable pursuant to Kentucky law. Accordingly, the CTA 8.17.12 Order should be reversed.

C. Sufficiency of Consideration

Appellee maintains that the COI Agreement was supported by sufficient consideration and relies on *Higdon Food Service, Inc. v. Walker*, Ky., 641 S.W.2d 750 (1982) in support of its position. However, as set forth in greater detail in Appellants' Joint Brief, *Higdon* is distinguishable from the present case.[2]

In *Higdon*, the Court held that, despite Walker's ongoing employment with Higdon prior to execution of the subject employment agreement, which contained a non-compete provision, execution of the employment agreement superseded the prior employment and, in effect, made Walker a newly hired employee. *See generally Higdon Food Service, Inc. v. Walker*, Ky., 641 S.W.2d 750 (1982). The Court considered this "new employment" as part of the consideration for the employment agreement and noted that he had received something more than continued employment as consideration. *Id.* at 751-52. The Court found there to be the additional requirement of "good faith" on the part of Higdon. *Id.* at 752.

Moreover, the *Higdon* Court based its holding on the terms of the contract considered as a whole. The Court stated that "[i]t is not necessary that each clause of a contract carry with it a specific consideration. It is sufficient if the overall agreement has a consideration." *Id.* at 752. In *Higdon*, the non-compete provision was only part of the overall employment agreement, which also included, among other things, the express terms that "Higdon 'hereby employs'

[2] Section II of the Joint Brief of Appellants is incorporated by reference the same as if set forth verbatim herein.

Walker "as a sales representative' and agrees to pay him according to a schedule of commissions." *Id.* This scenario is very different from the one in the present case.

Here, while the COI Agreement is purportedly part of a larger document, Appellee has produced no such evidence. Furthermore, the COI Agreement does not contain any of the terms regarding employment, salary, position, etc. that was present in *Higdon* and which played a part in the *Higdon* Court finding adequate consideration for the employment agreement. The COI Agreement was not supported by sufficient consideration and is unenforceable.

Additionally, as recognized in the CTA 8.17.12 Order, *Higdon* has been highly criticized as being based on "a fictitious bargain which was further fictionalized through the rescission theory." J. Leibman and R. Nathan, *The Enforceability of Post-Employment Noncompetition Agreements Formed After At-Will Employment Has Commenced: The 'Afterthought' Agreement*, 60 S.Cal.L.Rev. 1465, 1533-34 (September 1987). Such a theory has been "rejected by virtually all scholarly commentary as a mechanism for avoiding the preexisting duty rule." *Id.*

However, while the Court of Appeals is quick to point out that *Higdon* has not been overruled and "remains precedent that this Court lacks authority to change," it fails to follow the binding legal precedent in *Calhoun*, *supra*, which it also recognizes "has never been explicitly overturned." (App. Item 6, CTA 8.17.12 Order, pp. 8 and 16).

II. THE COI AGREEMENT IS VOID AS AGAINST PUBLIC POLICY

Appellants thoroughly addressed the public policy concerns frustrated by the proposition that Kentucky Courts have an unfettered authorization to re-write non-compete agreements so as to make them enforceable in their primary brief.[3] Accordingly, those public policy arguments will not be repeated herein. However, Appellants will briefly address a few of the public policy arguments advanced by the Appellee.

[3] Section I.B.3. of the Joint Brief of Appellants is incorporated by reference the same as if set forth verbatim herein.

Appellee portrays the "equitable modification" of non-compete agreements as promoting order and protecting the interests of both the employer and the employee. This is simply not the result which would occur from such an open-ended, unrestrained grant of power. Moreover, such power is not supported by Kentucky precedent.

In *Woodruff, supra*, the Court, in addressing the equities of enjoining an employee, included the following determination:

> To require him either to change his occupation, which he had followed for some three years, or to remove to a different community, was a harsh burden on him. A man's right to labor in any occupation in which he is fit to engage is a valuable right, which should not be taken from him, or limited, by injunction, except in a clear case showing the justice and necessity therefor.

Woodruff, 245 S.W.2d at 450. This equitable principle is further expounded on in *Calhoun, supra*, where the Court stated as follows:

> Restraint of employment tends to deprive the public of efficient service as well as to impoverish the individual and reduce him to the status of a public charge. In this country there has recently arisen a school of thought which places much importance on the plight of the individual who might be needlessly pauperized while ready, able and willing to work at his usual occupation for the support and independence of himself and family. Equity will not enforce the named terms of a negative covenant restraining a man from other employment unless the employer has a substantial right peculiar to his business which it is the duty of the court to protect, if it can do so without imposing an undue hardship upon the employee.

Calhoun, 242 S.W.2d at 103. Thus, public policy clearly does not favor an unreasonable restraint on trade which prevents an employee from self-sustenance through his chosen and practiced career. It is only where such a restraint is narrowly tailored by the parties and reasonable under the circumstances that the restraint will be enforced.

To allow any court to unilaterally insert a material term into a contract where the said term was not negotiated or agreed to by the parties is contrary not only to public policy and established rules of contract construction, but to the very meaning of "equity." Such a rule

would promote the use of broad, poorly defined non-compete agreements by employers by providing a safety net whereby the Court could save the employer from its own legally deficient contract. Moreover, an employee would be unable to determine the extent of his/her restraints with any reasonable degree of certainty. It would remove the power of negotiation and mutuality from the contracting parties and place it in the Court's hands.

Brown was 54 years old when this litigation began. He has worked in the hay business for more than 40 years. He only worked for the Appellee for 18 of those years. Moreover, Brown only worked for the Appellee for 2 years after he signed the COI Agreement. To enforce a legally deficient non-compete agreement by allowing the Court to insert a material term which did not exist when Brown signed the COI Agreement is patently unfair and would cause an undue hardship. It is this type of situation which was contemplated by the *Woodruff* and *Calhoun* Courts and which is the basis for public policy against broadly sweeping, indefinite non-compete agreements. As such, the COI Agreement is void as against public policy.

CONCLUSION

For all of the aforementioned reasons, the Appellants, Brown and Standlee, respectfully request that this Court reverse the CTA 8.17.12 Order and uphold the summary judgment originally entered by the Fayette Circuit Court.

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