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Change in Compensation Voids Massachusetts Non-Compete Agreement

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Author: Diane M. Saunders (Boston)

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Under well-settled Massachusetts law, a material change in an employee's employment relationship requires the execution of a new restrictive covenant if the change creates a new employment relationship. In *Grace Hunt IT Solutions, LLC v. SIS Software*, Superior Court Civil Action No. 12-80-BLS1 (Lauriat, J.), the Massachusetts Superior Court recently clarified the law in this area finding a material change where the employees' compensation structure, although not their base salary, was changed and where the employees were asked, but refused, to sign new restrictive covenants.

In this case, two employees had signed a non-compete agreement with their former employer, Grace Hunt LLC. The third employee had never signed any agreement with the company. Prior to the workers' departure, Grace Hunt IT Solutions, a firm providing software management services, purchased Grace Hunt LLC. Even though the old non-compete agreements contained assignment clauses, the successor company asked the workers to sign new non-compete agreements. All three employees refused to sign new agreements with the successor employer.

Grace Hunt IT Solutions also announced a new compensation structure under which employees would receive a 20 percent reduction in base salary with the opportunity to earn more through bonuses based on billable hours. Even though the successor company guaranteed the base salaries of two of the employees for a certain period of time following the commencement of their employment, and even though their fringe benefits were reportedly more favorable, the employees believed that they would make less money for the successor company than they had for Grace Hunt, LLC because there was insufficient work available to them to meet the billable hours bonus targets. Accordingly, all three employees resigned and started working for SIS Software, a competitor. Grace Hunt IT Solutions then sought a preliminary injunction prohibiting the former employees from competing with them and soliciting its customers.

In denying the preliminary injunction motion, the court first noted that it was "extremely significant" that the employer had sought to have employees sign new non-compete agreements because it signaled that the old arrangement had been abandoned for a new relationship. Second, the court found that the change in compensation structure constituted a material change in the employment relationship even though the base salaries were guaranteed for a certain amount of time and the employees had not yet

suffered any decrease in their compensation. Moreover, the fringe benefits were reportedly better under the new structure. In finding the change in compensation structure to be material, the court relied on evidence presented to the effect that the employees might suffer some loss of compensation in the future under the new structure, which included a bonus that was tied to billable hours, because there might be some period of time when there would be insufficient work for them to meet the bonus hours target. In so finding, the court noted that it “is the existence of a material change in the relationship that voids the prior non-compete agreement, not the nature of that change.”

While the court’s decision in *Grace Hunt IT Solutions, LLC v. SIS Software* arose in the context of a purchase transaction, its teachings are applicable to all employers utilizing restrictive covenants in the Commonwealth of Massachusetts. Employers that ask employees to sign new restrictive covenants need to be alert to the fact that they may not be able to enforce prior restrictive covenant agreements with those employees if the employees refuse to sign the new agreements. Also, employers should be aware that changes in compensation structures and methodologies may void their existing restrictive covenants.

If you have any questions regarding this decision or its impact on your workplace, contact the Ogletree Deakins attorney with whom you normally work or the Client Services Department at 866-287-2576 or via email at clientservices@ogletreedeakins.com.

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