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Unfair Competition & Trade Secrets | A Littler Mendelson Newsletter

Competition from Former Employees: Important New Decisions Regarding Enforcement of, and Challenges to, Noncompete Agreements

By Thomas M. L. Metzger and Erik Hult

Several important covenant not to compete decisions have been issued recently by the U.S. Court of Appeals, Sixth Circuit, and in the federal district courts within the Sixth Circuit (which includes the states of Ohio, Michigan, Kentucky, and Tennessee). Three of the most recent cases deserve particular notice because they address an employer's liability under noncompete agreements, as well as important challenges to such agreements. For example, as discussed below, where an employer knows that recruits have noncompete agreements with their former employer, but the new employer chooses to entirely ignore the agreements, substantial liability can follow. On the other hand, if an employer attempts to enforce a noncompete agreement against an employee who is fired without explanation or cause, and in a manner inconsistent with its standard practices, courts may give the employer's agreement less respect. Also, the new decisions highlight the importance for employers of identifying and protecting trade secrets and other confidential information when confronted with competition from former employees.

Chicago Title Insurance Corporation v. Magnuson, et al.: A Case Against Employee Raiding

James Magnuson had established his own title insurance company in Ohio. In 1991, he sold his business to Chicago Title Insurance Corporation. As part of this sale, Magnuson accepted a position at Chicago Title, and agreed with Chicago Title that he would not compete with the company within five years of the end of his employment. Magnuson's noncompete agreement also provided that he would not work for another title insurance company in a seven-county area surrounding Columbus, Ohio. Magnuson quickly advanced through a variety of management positions at Chicago Title.

Subsequently, a competitor to Chicago Title, known as First American, embarked on a strategy to expand its business; and a part of the strategy apparently included efforts to recruit qualified individuals from competing companies. First American contacted Magnuson and convinced him to leave Chicago Title - despite his noncompete agreement. Indeed, First American offered Magnuson full indemnity on the noncompete agreement. Along with Magnuson, First American also began recruiting other key Chicago Title employees (and customers) from central Ohio. After three months of intense recruiting, thirty employees left Chicago Title for First American.

Chicago Title responded by suing for breach of contract, tortious interference, and a variety of other claims. Ultimately, after the district court granted Chicago Title's motion for summary judgment on certain issues, the court sent the question of damages to the jury. The jury returned a verdict of $10.8 million in compensatory damages, and $ 32.4 million in punitive damages, against the defendants.

On appeal, First American challenged, among other things, the validity of the noncompete agreement, as well as Chicago

Title's claim that its protectable interests had been harmed. The Sixth Circuit in Chicago Title Insurance Corp. v. Magnuson (No. 05-4411, May 2007) disagreed with these particular arguments in several respects. First, the Sixth Circuit held that because the violations had occurred within two years, whether a five-year noncompete period was enforceable was not particularly central to the issue of liability. The Sixth Circuit also held that Chicago Title did have an interest in employee and customer relationships worthy of protection in the marketplace, and that First American's practice of employee raiding infringed on those interests. Thus, the Sixth Circuit affirmed the district court's grant of summary judgment to Chicago Title on the breach of contract and the tortious interference claims.

First American also challenged the award of punitive and compensatory damages, arguing that a punitive damage award was inappropriate in this case, and that compensatory damages on Chicago Title's lost volume seller claim were also inappropriate. Here, the Sixth Circuit agreed, holding that First American's conduct was not sufficiently reprehensible to support an award of punitive damages in this case. Specifically, the Sixth Circuit noted that while First American acted with malice, there were no physical injuries or threats to personal safety as a result of the company's conduct, and malice alone was not enough to support a punitive damages award. Thus, while the motions for summary judgment as to the primary causes of action were upheld, the Sixth Circuit ordered a new trial on compensatory damages consistent with its opinion, and threw out the punitive damages claim altogether.

Lantech v. Yarbrough: If You Seek Equitable Relief, Show That You Have Been Equitable

The Sixth Circuit Court of Appeals also recently decided another important covenant not to compete case involving the manner in which an employee is terminated, and the enforcement of post-employment restrictions. Lantech, a company that manufactures and sells commercial packaging equipment and case-erecting equipment, hired Curt Yarbrough as a regional sales manager in 2002. As a condition of his employment, Yarbrough signed a noncompete agreement, which barred Yarbrough from working for any of Lantech's competitors for two years after his separation from the company, in any area where Lantech was located.

Yarbrough was terminated in April 2006, immediately following satisfactory performance reviews that indicated that he was working with passion, improving considerably, and had substantially improved his sales. Lantech fired Yarbrough over the phone, did not provide him with any reason for his termination, denied him a severance package, terminated his insurance plan, and did not assist Yarbrough in obtaining other employment, despite the company's standard practice of assisting other terminated employees who had signed noncompete agreements.

Soon after he was terminated by Lantech, Yarbrough was hired by Wexxar as a regional sales manager for an area entirely different than the area he covered for Lantech. In July, 2006, Lantech requested an order preliminarily enjoining Wexxar from continuing to employ Yarbrough, but the district court denied the request, citing the particular circumstances surrounding Yarbrough's termination, noting that it was "abrupt, peremptory, and without explanation."

On appeal, the Sixth Circuit affirmed the district court's refusal to order a preliminary injunction, stating that Lantech's inequitable conduct in the termination of Yarbrough was a "sufficient, 'independent ground,' for determining that Lantech was not likely to succeed on the merits . . ." In reaching this decision, the Sixth Circuit noted that the manner in which Yarbrough was terminated was in violation of the company's own employment termination policies and that Lantech had misrepresented these employment policies when it hired Yarbrough. Here, the Sixth Circuit, like the district court, noted that Lantech had fired Yarbrough in the middle of his evaluation period and not did not help him obtain new employment. Thus, because Lantech had acted inequitably in firing Yarbrough, and in violation of its own policies, the Sixth Circuit affirmed the district court's ruling that the preliminary injunction should be denied. In other words, the court essentially concluded that where the employer had been inequitable toward its employee, it will not award the employer equitable relief in the form of an injunction against the employee.

Recovery Express v. Warren County Fraternal Order of Police: Protecting Company Records

Finally, a recent district court decision focused on the type of information that can be protected by an employer. Recovery Express, a corporation also known as "Children's Benefit," assists non-profit organizations such as the Warren County Fraternal Order of Police (FOP) by contracting to help them solicit funds. Children's Benefit raises funds by contracting with individuals to be solicitors who seek donations for FOP activities designed to raise charitable contributions.

In this case, Children's Benefit entered into an agreement with two individuals to solicit donations for the FOP, and provided these individuals with a stack of index cards that contained potential donors' names, addresses, donation histories, etc. Upon entering into this subcontract, these two individuals signed written agreements acknowledging that these index cards and other corresponding records were the property of Children's Benefit.

At the end of 2004, the FOP terminated its relationship with Children's Benefit. The FOP then attempted to continue the solicitations through the two subcontracted individuals, and to keep the relevant index cards and information, without compensating Children's Benefit. Children's Benefit/Recovery Express sued, seeking a declaration that the cards were trade secrets, and that the two subcontracted individuals had signed valid noncompete agreements requiring that they return all records. Children's Benefit also asserted that by refusing to comply with this request, the FOP was tortiously interfering with a business relationship. The defendant, the

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Warren County Fraternal Order of Police, filed a motion to dismiss, arguing that the index cards were neither trade secrets nor protectable interests.

The court agreed with Children's Benefit, holding that Recovery Express appeared to have undertaken reasonable efforts to maintain the secrecy of the index cards, and the court went on to explain that the question of whether the information available on the note cards was easily obtainable could not appropriately be resolved on summary judgment. On the claim by Children's Benefit that the FOP had tortiously interfered with its business relationships, the court found that the contractual obligations of the two subcontracted parties were legitimate, and that if the FOP knew about such agreements, it may very well be liable on this claim. Thus, the court denied the FOP's motion for summary judgment as to both claims, and ordered the case to proceed.

What Does this Mean for Employers?

These recent and important federal court decisions emphasize that employers must be certain to act with care when recruiting - or terminating - individuals with seemingly valid noncompete agreements. Repeatedly ignoring all aspects of a competitor's non-competition agreement, or attempting to enforce such agreements against employees who were terminated in a questionable manner, may lead to judicial consideration of equitable principles outside the language of the contract itself. Such acts, or omissions, can leave employers in an uncertain and perilous position on a variety of critical issues, including exposure to monetary damages from a competitor, significant legal costs, or judicial refusal to enforce what otherwise may have been a valid noncompete agreement. In addition, employers who seek to enforce non-competition and nonsolicitation agreements must diligently and meticulously protect any trade secrets and other confidential information to which employees had access, or risk that the underlying agreements will not be enforced.

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