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$43 Million Award Shows Complexity Of Noncompetes

BY JARRETT BANKS

NONCOMPETE agreements are inherently tricky in a free market system. Companies need to protect themselves against their employees taking information, training and secrets to a rival company. Employees need to protect their right to career advancement. So when a jury in Columbus, Ohio, awarded an insurance company $43.2 million on Jan. 25, because a former executive went to a rival insurance company and aggressively recruited several of his old colleagues, both employees and employers took notice.

Chicago Title Insurance Co. sued its former executive James Magnuson in 2003 for breaching his noncompete agreement and his new employer, First American Title Insurance Co., for inducing him to violate the agreement. According to the complaint in the case, *Chicago Title Insurance Co. v. James Magnuson, et al.*, Chicago Title lost 32 employees over several months to the First American Title's "Talon Group," which hired Magnuson after he left Chicago Title. Chicago Title claimed Magnuson recruited its employees and helped First American Title divert business from Chicago Title between 2002 and early 2003.

The case pitted two giants of the title insurance industry—which has seen a boom in recent years because of a rise in home sales and refinancing.

The 15-day trial before U.S. District Judge Gregory L. Frost ended with a verdict that included $10.8 million in compensatory damages and $32.4 million in punitive damages, as well as attorneys fees for Chicago Title.

The case is noteworthy primarily because of the amount of money involved, according to Martin Carroll, a partner at Chicago-based Fox, Hefter, Swibel, Levin & Carroll, who deals with trade secret cases for companies seeking to enforce noncompete agreements.

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—Martin Carroll
Partner
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"I haven't seen such a large punitive damage verdict in one of these cases before," Carroll says. "I think they were able to show all this pattern of events to the extent that it angered the jury."

The Enforcers

Carroll says the courts always have had a mixed view of noncompetes. "On the one hand, they view them as anti-competitive, on the other hand they say 'we don't think it's fair necessarily that certain employees can just leave and bring business information and trade secrets with them,'" he says. "You discourage companies from spending money on innovation and on developing clients if someone can just walk out the door and compete with them."

It is the job of in-house counsel and the HR department to evaluate and enforce non-competes. And in any highly competitive industry, in-house counsel eventually will face the issue of noncompetes from both sides of the fence if the company is aggressive about recruiting.

"You need to not be afraid to carry the big stick and send a message to your competitor," says Steven A. Goldfarb, lead counsel for the plaintiff in *Chicago Title* and partner at Hahn Loeser & Parks. "You can get additional business value out of litigation by sending the right message and letting competitors know that you are going to protect your top producers from being recruited."

When deciding if a noncompete is enforceable, courts will look at the length of the agreement, type of activities it bars and geographical limitations.

"Noncompetes need to be narrowly tailored geographically, protect your core interests and span no more than two years," Carroll says.

If a company believes an employee is violating a noncompete agreement, it needs to get an injunction by establishing immediate and irreparable harm. It also needs to begin looking at the potential litigation strategies.

"Normally the business people are not attuned to that aspect of it when the situation arises," Goldfarb says.

Typically they will first write a letter to the former employee and tell him to cease and desist, and then pursue litigation. A company must be able to prove that the employee is sharing a protectable business interest—contacts with clients, knowledge about the company or trade secrets—with a competitor.

Employers also must show consideration for the noncompete. Courts usually will find consideration if the employee

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worked for a reasonable length of time at the company after signing the agreement.

In light of *Chicago Title*, some companies are worried they may have to re-evaluate their noncompete agreements. But Goldfarb believes the game hasn't changed that much.

"Most sophisticated companies are always re-evaluating their noncompetes," Goldfarb says. "It's a balancing act because you want them to be effective but you don't want to scare away the best talent. Employees are always resistant to noncompetes and companies are always trying to overreach and get as much as they can."

Recruiting Checklist

If your company wants to recruit or hire a competitor's employee, it has to be extremely careful to avoid this kind of liability. Carroll recommends you look into whether a job candidate has a noncompete with his former employer, if he has recruited other employees before leaving, and if he has any trade secrets from his former employer. If the answer to any of those inquiries is "yes," that candidate may become more of a liability than an asset.

"The benefits to [First American] ... maybe they benefit a couple of million dollars in profits for a few years—that's not worth a $40 million dollar hit," Goldfarb says. "It's a message that's going to be heard."

As an in-house attorney, the key is to exercise sound business judgment—both in terms of your competitors' noncompete agreements and your own.

"Sometimes your job is to convince companies that they don't need them for certain individuals because it's not going to be enforceable and you really should save it for key individuals," Carroll says. "There is some advantage in trying to narrow down the pool of who you're asking to sign these."

As the appeal process now begins—a process that could take years—the case may have already made its mark on the way in-house counsel view incoming and outgoing employees.

"It's got the potential for being a landmark type case in this area of the law," Goldfarb says.