MEALEY'S® LITIGATION REPORT
Intellectual Property

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A commentary article reprinted from the July 8, 2024 issue of Mealey's Litigation Report: Intellectual Property

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Commentary

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[Editor's Note: Geri Haight is a Member in the Boston office at Mintz who has a multifaceted practice focusing on employment litigation, counseling, and compliance, as well as intellectual property and trade secret matters. Danielle Bereznay is an Associate in the Washington, DC office at Mintz who defends and counsels clients on restrictive covenant agreements, discrimination, harassment, and retaliation claims, employment and separation agreements, and employee handbooks and company policies. Any commentary or opinions do not reflect the opinions of the firm or LexisNexis®, Mealey Publications™. Copyright © 2024 by Geri Haight and Danielle Bereznay. Responses are welcome.]

Businesses have long relied on non-compete agreements as an important tool to protect their confidential information and trade secrets by limiting a departing employee's ability to work for a competitor. Employers have also used non-competes to prevent the poaching of their employees by competitors. Non-compete agreements have come under heavy scrutiny in recent years, with a looming nationwide ban imposed by the Federal Trade Commission ("FTC") set to come into effect in early September. Within hours of the FTC's adoption of its final rule banning non-competes, however, it was challenged in a federal court, leaving the status and effect of the new rule in flux.[1] So, what should businesses do?

The legal landscape impacting non-competition agreements on the state and federal level has rapidly changed over the past several years, with businesses finding it increasingly difficult to manage a multistate workforce amid varying jurisdictional requirements. In addition to the FTC's adoption of its final rule banning non-competes, state legislatures too have imposed a wide variety of restrictions on the use of employment-based noncompetition agreements (such as in the State of Washington and Washington, D.C.) or have banned them outright (most recently, Minnesota for new employees). In California, where non-compete restrictions have been banned for over 100 years, California businesses now have an affirmative obligation to notify employees that any non-compete the employee signed is void and unenforceable. Other states, like Massachusetts, Colorado, Idaho, Illinois, Virginia, Washington, Oregon, and Washington, D.C., have limited the applicability of non-competes to employees that meet a specific salary threshold, have a certain level of position, are exempt and/or have been provided with additional consideration to support the restriction. Given these jurisdictional requirements, there no longer is such a thing as a non-compete agreement "template" that a business can use uniformly across its workforce. Rather, such agreements need to be tailored to closely track developments in state law, potentially creating a lack of uniformity among employees. Given the varying obligations of a business with employees located across the country under state laws and the complexities involved in administering a multi-state non-competition agreement, some businesses have already scraped the use of non-compete agreements entirely and chosen to rely on other protections for their businesses, not waiting to see whether the FTC ban comes into effect.

Given the present uncertainty, now is the time for businesses to prepare to protect their proprietary information and trade secrets and defend against competition. Apart from non-compete agreements, other protections are available to employers that have a similar, if not stronger, protective effect. We review below some considerations for employers in a post-non-compete world.

The Effect of Non-Compete Restrictions on Employee Hiring and Retention

Whether a business decides to move away from the use of non-compete agreements due to the anticipated FTC ban or due to the complexity in administering such agreements across a multistate workforce, a shift away from the use of non-compete agreements will have a profound effect on the recruiting and hiring process. In issuing its final rule, the FTC estimated that, as a result of a federal ban on non-compete agreements, more than 8,500 new businesses will be formed each year.[2] It also estimated that the average worker's wages would increase by $524 annually and that health care costs would be lowered.[3] Whether or not the FTC's final rule is upheld, its data is instructive. The absence of non-compete agreements will result in notable changes in recruiting and hiring processes.

For example, employees will be able to move between jobs more seamlessly, which will lead to an increased number of candidates for certain jobs and in industries where employee mobility has historically been limited by non-compete protections. Employee mobility will be easier than ever. The candidate pool will also increase, making recruitment and hiring of top talent easier.

On the flip side, workers will have more freedom to choose where they want to work and for whom, including competitors. Businesses will be vulnerable to poaching and will be required to think creatively about how to retain their workers and create a sense of loyalty to the company. Some approaches to this issue may include offering a mix of monetary and non-monetary compensation, such as remote work and continued education opportunities. Businesses will need to think about what their workforce wants and ways in which they can leverage that to retain their workers.

With increased employee mobility comes increased concern that employees may take confidential information, clients, and customers with them, increasing the risk of breach of contract and trade secret misappropriation claims.

Leveraging Other Protections: Trade Secret Laws, Confidentiality Agreements, and Non-Solicit Provisions, and Garden Leave

How can a business protect itself? The move away from non-compete agreements is not the end of the road. Businesses can use a number of other well-established protections in their employment agreements with their workforces. We focus on a few below, highlighting trade secret protections, confidentiality provisions, non-solicit provisions, and garden leave.

Trade Secret Protections

With this shifting landscape, trade secret protection laws will take the center stage. The federal Defend Trade Secrets Act, the Uniform Trade Secrets Act, as adopted by many states, and similar state laws offer important protections for businesses and are alternatives to the protections that non-compete agreements have offered.

One of the benefits of trade secret protections is that, unlike non-compete agreements, which have been heavily scrutinized by courts, trade secret statutes offer significant legal protections and are more consistently upheld. And, trade secret protections, unlike non-compete agreements, do not have temporal or geographical restrictions – meaning, they can last many years and follow a departing employee wherever they may go. Generally, under trade secret laws, a business may seek injunctive relief and damages for misappropriation of its trade secrets, which is similar relief to what a business may seek for breach of a non-compete agreement. Businesses seeking to protect their trade secrets by bringing misappropriation claims may have a higher likelihood of success, including through jury verdicts.

In leveraging trade secret protection laws, however, businesses must take active steps to ensure that they are treating sensitive proprietary information such that it could be considered a trade secret under the law. This is two-fold: the business must be able to show that the information is, in fact, a "trade secret", i.e., something with commercial value that it is not generally known or ascertainable, and that it has taken reasonable measures to protect.

As to this second factor, it is critically important that businesses assess both their policies and their procedures concerning employee access to and storage of such information in order to prevent misappropriation. Particular focus should be given to employee processes. For example, when onboarding an employee, one basic step to ensure is completed is to get a signed restrictive covenant agreement with each employee, one that includes among other things, nondisclosure obligations. Seems simple and obvious, but this step often missed in the rush to bring on new talent. Employee agreements should be audited regularly to ensure completeness. Then, there are several practices that should be implemented to protect proprietary information throughout the employment lifecycle, such as:

- Storing and handling Company information in a secure manner;
- Restricting access to the information, by using physical and technological restrictions;
- Regularly auditing Company computer usage, including random monitoring;
- Requiring regular password changes and encryption/non-disclosure of passwords;
- Distributing encrypted storage devices and prevent non-encrypted storage devices from accessing Company systems;
- Requiring an employee to acknowledge compliance with security policies and procedures each time they into the company system or network;
- Retaining the right to inspect personal computers, devices and, phones;
- Using access control/access tracking software;
- Marking information as confidential; and
- Training employees periodically on security protocols.

When offboarding an employee, employers should remind the employee of their non-disclosure and other continuing obligations. Businesses should ensure that departing employees return their company devices so that they can track whether the employee downloaded, forwarded, saved, or otherwise took confidential and/or proprietary information with them when they left. For key employees, data and devices should be preserved so that information critical to a potential misappropriation claim is not lost.

In taking these steps, a business will be well positioned to articulate to a court that the information is valuable and that it has taken steps to protect the information from being taken by a departing employee.

Confidentiality Agreements

While businesses have routinely asked their employees to enter into agreements containing both non-competition and non-disclosure obligations, as companies move away from non-competes, employee confidentiality provisions have increased importance. Businesses can and should include in their employment agreements provisions that require an employee to maintain the confidentiality of trade secrets and other confidential information. Strong confidentiality provisions help to protect a business' interests, and this is especially true where a confidentiality provision is coupled with other helpful provisions, such as a favorable forum selection provision and provisions for damages in the event of a breach.

Generally, unlike non-competition provisions, confidentiality obligations are not viewed as a restraint on a departing employee's ability to find other work. Thus, there are fewer limitations and restrictions under both state and federal law as to how they are written. For example, non-disclosure obligations typically are not subject to any reasonableness standards and do not have any geographical or temporal restrictions. Confidentiality agreements are also not limited only to the protection of only trade secrets; they can be broadly written to include information deemed confidential by the business and can impose a duty of confidentiality on the employee.

Non-Solicitation Provisions

Should the FTC's non-competition ban come into effect, businesses may continue to rely on non-solicit agreements, which have survived scrutiny by the FTC and most state laws. Because non-solicitation agreements prevent a departing employee from inducing their former co-workers to leave their current employ and/or prevent a departing employee from taking customers or clients with them, they are generally viewed in a more favorable light and not a restraint on an employee's ability to find work, as non-solicitation agreements do not prevent a departing employee from working at a competitor, and only prevent the poaching of other employees and/or customers and clients. A non-solicit agreement will protect the business's revenue by maintaining its employees, customers, and clients.

Unlike trade secret protections and confidentiality provisions, non-solicit agreements are like non-competes in that they are generally required to be reasonable and include a temporal and geographical scope to be enforceable. For example, a court may find that a non-solicit agreement that prevents an employee from soliciting any current or prospective customer of the business is overbroad and not enforceable. A non-solicit agreement may, like a non-compete agreement, need to include more specific limitations, such as that an employee may not solicit customers or clients that they worked with in the prior two years before their separation from employment (further, some states have salary thresholds for non-solicitation agreements, such as Illinois and Colorado).

A business will need to consider whether including a temporal and geographical scope is feasible or if the business's preference is not to have a provision that includes any such limitations. Of course, a non-solicit can be used in conjunction with a confidentiality and other protective provisions.

Garden Leave and Monetary Considerations

In addition to the other protections, as either a supplement to or replacement for non-compete protections, businesses can also take a monetary approach to protecting their confidential information and trade secrets. For example, should the FTC's non-compete ban come into effect or if administering non-compete agreements to a multistate workforce become too cumbersome, a business can and should include a garden leave provision in employment agreements. Garden leave provisions typically require an employee to provide advanced notice of their resignation but remain on the payroll as an employee for a period of time after their resignation notice (such as three months). The idea behind garden leave is to keep the employee from being hired at a competitive company and to create time and space between the employee's current work and any work they will be doing at their new employer. Although some businesses may be skeptical of paying employees their full salary, or a substantial part of their salary when they are not performing work, such an approach may be well worth it to protect important information.

A slightly different, but potentially equally effective approach to protecting proprietary information and trade secrets could be to condition an employee's annual discretionary bonus on providing advanced notice of a resignation or require that an employee meet certain transition requirements in order to receive the bonus (however, it is important to take note of state laws that dictate compensation).

To retain employees and limit turnover, especially of those who have access to trade secrets and confidential information, businesses may also consider retention bonuses or other benefits to incentive employees and minimize potential competition.

In Closing

An overbroad approach to non-compete agreements is no longer an effective strategy to protect a business' information, particularly for companies that have employees in many states. Increasing complexity in administering non-competes across a multistate workforce coupled with the looming threat of the FTC's ban highlight the importance of employee confidentiality and non-solicitation obligations, as well as the need to evaluate existing policies and practices to identify and address existing gaps in securing proprietary information and trade secrets.

Endnotes

1. *Ryan, LLC v. The Federal Trade Commission*, Case No. 3:24-cv-986 (N.D. Tx.).
2. FTC Announces Rule Banning Non-Competes, April 23, 2024, https://www.ftc.gov/news-events/news/press-releases/2024/04/ftc-announces-rule-banning-noncompetes.
3. *Id.* ■

MEALEY'S LITIGATION REPORT: INTELLECTUAL PROPERTY
edited by Scott Heavilon
The Report is produced twice monthly by

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Telephone: (215)564-1788 1-800-MEALEYS (1-800-632-5397)
Email: mealeyinfo@lexisnexis.com
Web site: http://www.lexisnexis.com/mealeys
ISSN 1065-9390