Contracting for Trade Secret Protection in the Post-Non-Compete Era

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Announcer
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Julian Dibbell
Hello and welcome to Tech Talks. Our topic today is the recent FTC ban on non-compete agreements and its potential impacts on Trade Secret Protection.

I'm your host, Julian Dibbell. I am a senior associate in Mayer Brown's Technology & IP Transactions practice. I'm joined today by Gail Levine and Kristine Young. Gail sits in our Washington DC office and co-leads Mayer Brown's global Antitrust & Competition practice. She helps clients with business-critical mergers or acquisitions facing antitrust issues. Kristine is a partner in our Intellectual Property, Brand Management and Litigation practice. She's based in Chicago, and has been advising clients on the protection and enforcement of trade secrets for over a decade. Welcome to both of you.

Gail, I guess I'd like to turn to you first because we're going to get to the impacts on trade secret protection of the recent FTC ban on non-compete agreements. But I think we need to just start with a basic overview of what that ban entails.

Gail Levine
Thanks Julian, and hello everyone. As you've foreshadowed, Julian, and as many people likely heard, the FTC has indeed promulgated a rule recently that makes unlawful almost all non-compete agreements between employers and workers nationwide. When the rule goes into effect (if the rule goes into effect) on September 4, it will render unenforceable all such agreements for the vast majority of U.S. workers, and it will make it unlawful to enter new agreements going forward.

There's an important "but" to all of this. And it's about non-competes with senior executives. Non-competes with senior executives entered before Sept. 4 will be grandfathered in. They will be enforceable. New ones entered after that date – unlawful.

So there's a lot of attention now on who is – and who isn't – a "senior executive." For the purposes of the FTC's rule, a "senior executive" is someone who makes a little bit more than $150,000 a year and is in a "policy-making position." That means you're an executive who has "final authority to make policy decisions that control significant aspects of a business entity or common enterprise." Those are the FTC's words. An executive who "just advise[s] on or influence[s] policy" is not a "senior executive" for the purposes of this grandfathering clause of the FTC's rule. The FTC estimates that less than 0.1% of U.S. workers are going to be senior executives – it's a pretty exclusive club.

Heads of divisions within companies, by the way, are "senior executives" only if they "exercise[s] a policy-making authority over the common enterprise in its entirety." They aren't "senior executives" if they only have policy-making authority over their divisions.

Is all of this just an academic exercise? We're going to find out soon. Within days of the FTC's announcement of its final rule on non-competes, three federal court challenges were filed to invalidate it. The fastest-moving case is the one filed in the Northern District of Texas. The court there is going to hold a hearing on the plaintiff's motion to preliminarily enjoin the FTC's rule on June 17, at least as currently scheduled. And I think the court has an aim of ruling by July 3. So we'll know more soon.

Julian Dibbell
So it's a sweeping ban and there's a lot hanging in the balance there with those rulings. I guess let's focus on the particular aspect of confidential information and trade secrets. How do you protect those in light of the ban. What can employers do to ensure that their confidential information and trade secrets are not shared?

Kristine Young
Thanks, Julian, and thanks for having me on Tech Talks. To answer your question, the non-compete ban has really placed the onus on employers to take proactive measures and extra precautions to now protect their confidential information and trade secrets, because the ultimate protection of restricting employees from going to work for a direct competitor has been stripped away. There are a number of measures, however, that employers can take to protect their confidential information and trade secrets both practically and contractually.

First and foremost, practically speaking, now more than ever employers should exercise heightened precautions to ensure only employees with a need for access to confidential information and trade secrets have that access. This may mean evaluating the confidential information and trade secrets that are material to the business and putting policies and access controls in place to ensure that only those with a need to know have access in the first place. This may also mean clearly marking confidential information and trade secrets as such, along with clear instructions that the information must not be disclosed to third parties or to anyone within the company who is not authorized. Furthermore, this may also mean implementing a policy that makes clear that any and all confidential information and trade secrets that an employee has access to during the term of employment must be returned to the company prior to an employee's departure and requiring employees to execute an affidavit attesting that all such information has been returned with no copies retained by the employee at the conclusion of their employment.

These measures are also important for establishing that information constitutes a trade secret should such information ever become the subject of a claim for misappropriation of trade secrets. To prevail on such a claim, in addition to showing that a trade secret derives independent value from being kept confidential, a plaintiff needs to show that the owner of the trade secret has taken reasonable measures to keep such information secret.

Julian Dibbell
OK, so those are key policy and practice measures. What about contractual measures? What can employers do there?

Kristine Young
Contractually, employers should review their employment agreements and craft those agreements so that they operate to compliment and supplement the protections afforded by trade secret law. In particular, this may include:

For one, crafting non-disclosure provisions to exclude only information that was previously known to the employee at the time such information was provided to the employee by the employer. This will protect against a scenario where information is deemed not confidential or not a trade secret at the time of disclosure, because, for example, it was disclosed publicly because another person or employee breached a confidentiality obligation or because it was created or discovered by the employee prior to or independent of the relationship with the employer. That being said, exclusion provisions should not be drafted so broadly that they are effectively non-competes in disguise, which could render the entire agreement unenforceable. For example, the non-disclosure provision should avoid broad prohibitions on using learnings from a role upon termination from employment when those learnings are not directly connected to confidential information or trade secrets.

Another point is defining confidential information and trade secrets broadly as discussed and also specifically to include any confidential information or trade secrets that the company knows are material to the business. The company can reserve its rights to update the definition from time to time if or when the new confidential information and trade secrets are developed or come to light.

Furthermore, the company can make non-disclosure provisions related to confidential information and trade secrets perpetual to mitigate the risk that those provisions will, at some point in the future, be deemed expired after expiration of the agreement term.

Additionally, employers can prevent the employee contractually from breaching the confidentiality and non-disclosure obligations and also preventing the employee from inducing others to breach those obligations or inducing others to acquire the confidential information or trade secrets by improper means. Such a provision provides another angle for a breach of contract claim in the event that an employee takes confidential information and trade secrets and uses them for the benefit of a new employer.

Additionally, employers should carefully consider forum selection clauses to resolve disputes. While arbitration can potentially be a cost-saving mechanism, in recent history, juries have returned nine-figure awards in trade secret misappropriation cases. In some cases, jury awards have been in the billions.

Finally, with all of the uses of mobile devices, employers should adopt a device inspection policy whereby the company is granted the right to inspect a departing employee's personal devices to ensure that there is no company confidential information or trade secrets on employee devices. That agreement and policy can make clear that the company owns the confidential information and trade secrets, regardless of where

it's stored. The agreement may also provide the company with an inspection right at any time during employment and to monitor, review or erase any trade secrets or confidential information from an employee's personal device at any time.

Julian Dibbell
OK, well, it sounds like there a lot of things that employers can do with respect to their agreements absent the ability to enforce a non-compete. I just couldn't help noticing your comment about nine-figure awards—awards in the billions—in some forums for trade secret violations. Obviously, that's a good thing for parties who are trying to protect their trade secrets. One would hate to be on the other end of that, be they the party that has violated a trade secret, particularly not wanting to. What can employers do to avoid being on the wrong side of a judgment like that, in the event that they hire an employee from a competitor who has had access to trade secrets?

Kristine Young
Good question. Protection from trade secret misappropriation claims is also important, and contracts can be helpful to employers on the front end as well. Putting the right contracts in place when an employee is hired can help a company defend against claims that an employee has misappropriated a former employer's confidential information or trade secrets and that the confidential information or trade secrets were improperly used by the employer. For example, at the time of hire, an employer can consider having employees acknowledge and attest that they are not and will not use any confidential information or trade secrets from any previous role and also make clear that such use of third-party confidential information or trade secrets is strictly prohibited and grounds for termination. This may include educating employees about the types of confidential information and trade secrets that the employee may have been exposed to in their previous role, as well as their duties not to disclose the same.

Additionally, employers can require employees to disclose and identify any restrictive covenant that they may have signed with a prior employer.

Furthermore, employers can put in place clear policies surrounding the protection of company confidential information and trade secrets and educate employees about those policies and best practices. They should remind employees regularly about the same, that those policies exist..

Finally, employers can have employees agree not to bring onto company premises or upload to company devices or systems any non-public information belonging to or obtained from a third party unless that party has consented to the same in writing.

Julian Dibbell
Well, it sounds like there are indeed a lot of protections employers can put in place in their employment agreements to address concerns they might otherwise have protected against through a non-compete. What about contracts with third-party contractors—suppliers of goods and services—that may involve interactions with employees of the contractor? What should businesses be keeping in mind in the wake of the FTC ban on non-competes with respect to those kinds of contracts?

Kristine Young
So although vendors, by way of not being employees, are not affected by the non-compete ban, employers should use this as an opportunity to review their vendor contracts and the provisions of those agreements governing the protection of confidential information and trade secrets, as well as what those agreements allow for in terms of access to sensitive information. Reviewing and updating vendor contracts to ensure appropriate protections of trade secret and confidential information is another piece

of the puzzle with respect to contractual measures employers and companies should take to safeguard their confidential information and trade secrets. For example, vendor agreements should specify which parties have access to confidential information and under what circumstances. Those agreements should provide for regular audits and compliance checks to ensure adherence to confidentiality obligations and require the return or destruction of confidential information upon termination of the contract. Those agreements may also include penalties for breach of confidentiality, such as injunctive relief and monetary damages.

Gail Levine
Another thing to think about when you're contracting with third-party vendors, our clients will often ask whether they can seek a non-solicitation agreement. I'll give you an example of a non-solicitation agreement between a couple of health care staffing agencies (think here, travel nurses). This is a case that was litigated in the ninth circuit not so long ago. One health care staffing agency was struggling to find enough travel nurses for the hospitals it served. So it wanted to contract with another health care staffing agency who could provide those extra travel nurses in order to do the job. That's pro-competitive, the court found: more hospitals receive more traveling nurses. But the company wasn't likely to be willing to deal with this third-party vendor if it meant risking losing its already very scarce supply of travel nurses to it during the collaboration. So the companies agreed not to solicit each other's nurses. And that was the issue that went before the ninth circuit.

The ninth circuit here found that that agreement not to solicit each other's nurses was not an antitrust violation. And the reasoning here is that the non-solicitation agreement was just ancillary to a pro-competitive agreement to get more nurses to more hospitals. [Aya v. AMN, 9 F.4th 1102 (9th Cir. 2021).]

Having said all that, courts do give non-solicitation agreements a careful look, to be sure. So, although they might not be a problem in the end, you probably want to touch base with antitrust counsel before inking non-solicitation deals like this.

Julian Dibbell
Well, sounds like good advice. Of course, we've been assuming throughout this discussion that we're in this brave new world where the FTC has banned non-competes and that's going to be the state of play going forward, but I have to ask, what if the courts do strike down this non-compete rule? Does that mean that companies can impose non-competes without restraint?

Gail Levine
No, it does not. It means that the background rules that have always applied will continue to apply. Even if the FTC's non-compete rule is defeated in the courts, that's not going to affect existing laws against anticompetitive non-compete agreements today. So, with that in mind, here are a couple of practical tips to minimize your chances of being in the cross-hairs of the FTC or others on this issue.

First, review the non-competes you have to make sure they are protecting legitimate business interests, like protecting your trade secrets, like protecting your confidential or proprietary information. Justifications like depriving competitors of your employees' talent is not going to be seen as a worthwhile justification for a non-compete.

And second, ensure that your non-competes are narrowly tailored to do what you need them to do. Are they broader in geographic scope or in industry scope than you need? Are they long enough to protect what you need in terms of protecting legitimate business interests? Or are they longer than you need?

The FTC has recently brought some enforcement actions in this space, and, in all those cases, it challenged agreements that lasted one year or more.

Julian Dibbell
Alright. Well, thank you, Gail, and thank you, Kristine. It was great to have you on the podcast today.

Listeners, if you have any questions about today's episode – or an idea for an episode you'd like to hear about anything related to technology and IP transactions and the law – please email us at TechTransactions@mayerbrown.com. And thanks for listening.

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