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Non-Compete and Trade Secrets Developments and Trends: A Year in Review and Looking Forward

Webinar

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Agenda

1. The Massachusetts Noncompetition Agreement Act
2. Other New State Laws and Legislative Efforts Regarding Restrictive Covenants
3. Federal Non-Compete Reform
4. Recent Restrictive Covenant Decisions
5. Trade Secrets Developments
6. Scrutiny of No-Poach Agreements
7. Practical Tips and Advice

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Massachusetts Noncompetition Agreement Act

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New Massachusetts Statute – The Basics

- § 24L of Chapter 149 of the Massachusetts General Laws
- Applies only to non-competition agreements entered into on or after October 1, 2018
- Leaves room for employers to continue protecting their legitimate business interests through other means, including non-solicitation and confidentiality provision
- A model for other states?

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Key New Requirements of New Massachusetts Statute

1. **Ten Days' Written Notice, Right to Consult Counsel.**
2. **Maximum Duration of One Year.**
3. **Payment During Non-Compete Period:** "garden leave" pay of at least 50 percent of the employee's highest annualized base salary within the two years preceding the employee's termination, or "other mutually-agreed upon consideration between the employer and employee, provided that such consideration is specified."
4. **Limited Geographic Scope:** areas where the employee "provided services or had a material presence or influence" during the last two years of employment are presumptively reasonable.
5. **Reasonable Scope of Prohibited Activities:** types of activities that the employee performed at any time during the last two years of employment are presumptively reasonable.

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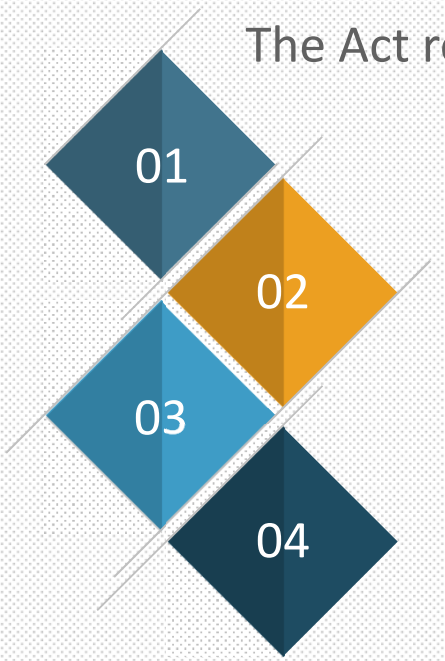
Massachusetts Noncompetition Agreement Act - Non-Competition Agreements Unenforceable Against Certain Classes of Employee



The Act renders non-competition agreements unenforceable with respect to four classes of employees:

(1) employees classified as non-exempt under the Fair Labor Standards Act,

(2) undergraduate or graduate student interns,

(3) employees terminated without cause, and

(4) employees age 18 or younger.

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Massachusetts Noncompetition Agreement Act

10 types of restrictive covenants NOT subject to its restrictions.

- (1) covenants not to solicit employees,
- (2) covenants not to solicit customers,
- (3) non-competition agreements made in connection with the sale of a business where the parties bound have an ownership interest in the business to be sold,
- (4) non-competition agreements outside of an employment relationship,
- (5) forfeiture agreements,
- (6) non-disclosure or confidentiality agreements,
- (7) invention assignment agreements,
- (8) garden leave agreements,
- (9) non-competition agreements made in connection with cessation of employment where the employee is expressly given seven business days to rescind acceptance, and
- (10) agreements not to reapply for employment to the same employer after termination of the employee.

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Massachusetts Noncompetition Agreement Act – Unanswered Questions

1. *Do the requirements of the statute apply to contractual provisions restricting the solicitation of prospective customers?*

2. *What qualifies as "other mutually-agreed upon consideration" as an alternative to the 50% of salary garden leave amount?*

3. *If an employer chooses to waive all or part of the non-compete period, must it provide the required consideration for the restricted period for the full period of time originally specified, or can it be cut off when the restricted period is waived?*

4. *Under what circumstances is a termination "without cause" within the meaning of the Act?*

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Other New State Laws and Legislative Efforts Regarding Restrictive Covenants

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2018 Statutory Developments – Utah

Amendment of Utah Code Annotated § 34-51-201 (effective May 8, 2018)

- Pursuant to Utah's 2016 Post-employment Restrictions Act (U.C.A. § 34-51-201) (the "Act"), an employer and an employee may not enter into a post-employment restrictive covenant for a period of more than one year from the day on which the employee is no longer employed by the employer.
- To address alleged non-compete abuses in the broadcasting industry in Utah, H.B. 241 was passed in March 2018 imposing special restrictions on the enforcement of non-competes against employees of "broadcast companies." This added a second section to the Act.
- Now, non-competes against such employees are not valid unless (1) the employee is paid $913 or greater a week; (2) the non-compete is in a written employment contract with a term of no more than four years; and (3) the employee is terminated for cause or breaches the employment contract.
- And, the duration of the non-compete cannot be longer than *the earlier of*: (a) one year after the employee's termination date; or (b) the expiration of the original term of the employment contract containing the restrictive covenant.
- Non-competes that do not comply with the statute are void.

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2018 Statutory Developments – Idaho

Amendment of Idaho Code § 44-2704 (effective July 1, 2018)

- In 2016, Idaho Code § 44-2704, entitled "Restriction of Direct Competition – Rebuttable Presumptions", was amended to make it easier for companies to restrict the movement of "key employees" and "key independent contractors."
- It provided that if a court found that a key employee or key independent contractor breached a non-compete agreement, a rebuttable presumption of irreparable harm was established, and the burden of overcoming that presumption shifted to the former employee to show that he or she had no ability to adversely affect the employer's legitimate business interests – in essence it required the employee to prove a negative.
- Reaction to the amendment was very negative. Because Boise, Idaho is trying to establish itself as a tech hub, and Idaho is trying to make itself more attractive to tech companies and their employees, the 2016 amendment was eliminated in the 2018 legislation.
- Burden has switched from the employee to employer, who must now show the employee's departure adversely affected the employer's legitimate business interests.

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2018 Statutory Developments – Colorado

Amendment of Colorado Revised Statutes § 8-2-113 (effective April 2, 2018)

- Colorado's non-compete statute, entitled "Unlawful to intimidate worker - agreement not to compete" (C.R.S. § 8-2-113), was enacted in 1982. The first time it was amended was in 2018.
- Since 1982, covenants not to compete could not restrict the right of a physician to practice medicine. However, in some cases Colorado law allows contractual provisions making doctors liable for damages if they compete and take patients.
- The 2018 amendment clarifies that physicians may disclose their continuing practice and provide new contact information to any of their patients who have a "rare disorder" without liability for damages to their former employers.
- Pursuant to the statute, the "rare disorders" must be recognized by the National Organization for Rare Disorders, Inc. ("NORD"), at www.rarediseases.org. According to NORD, more than 1,200 diseases are considered rare in the United States.

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Statutory Developments – Proposed and Rejected Legislation (2018)

Pending

- **New Jersey – A.B. 1769 and S.B. 2872**

  Proposed legislation would significantly curb the use of non-competes in New Jersey.

  - 30-day advance notice of provision or at time of offer
  - Non-compete shall not be broader than necessary to protect the legitimate business interests of the employer
  - Time period of the non-compete must not exceed 1 year following the date of termination of employment
  - Unenforceable against all non-exempt employees, as well as other types of short-term or low-wage employees
  - Unless terminated for misconduct, the employee must be paid 100 % of their pay during non-compete period
- **Vermont – H.B. 556**
  - Would prohibit agreements that prohibit individuals from competing with their former employers following the conclusion of their employment (with limited exceptions)

Rejected

- **Pennsylvania – Freedom to Work Act (2017 Pa. H.B. 1938)**

  Proposed legislation sought to prohibit enforcement of covenants not to compete except in limited exceptions – recently died in committee and has not yet been reintroduced.

  - Covenants not to compete would be illegal, unenforceable and void as a matter of law; courts not permitted to rewrite a covenant not to compete
  - Limited exceptions: (1) sale of business; (2) dissolution of partnership or LLC; (3) reasonable non-compete in effect prior to effective date of legislation
- **Washington – H.B. 2903 and S.B. 6522 and 6526**: Sought to impose significant restrictions; died because of concerns with income threshold
- **New Hampshire – S.B. 423**: Sought to prohibit non-competes for low-wage employees

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Federal Non-Compete Reform

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Federal Non-Compete Reform?

MOVE Act

- In 2015, Congress attempted to enact restrictive covenant reform with the introduction of the Mobility and Opportunity for Vulnerable Employees, or MOVE Act.

- Had it passed, the MOVE Act would have prohibited non-compete agreements between employers and low-wage earners, those who:
  - Earned less than $15 per hour or the minimum wage in the employee's municipality; or
  - Earned less than $31,200 per year.

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Federal Non-Compete Reform?

Obama Administration's Call for Restrictive Covenant Reform

- During the Obama Administration, the White House and U.S. Department of Treasury issued two reports of the "overuse" of restrictive covenants across the country, and called for action.
- The White House provided state legislatures with specific "best-practice policy objectives" aimed at curbing "overuse" and "misuse" of restrictive covenants. Three potential areas of reform were identified:
  - Banning non-competes for certain categories of workers (such as low wage-earners, those employed in public health and safety positions, or those laid off or terminated for cause);
  - Improving the transparency and fairness of non-competes (through notice or consideration provisions or regulating the timing of execution); and
  - Encouraging employers to draft enforceable agreements through the adoption of the "red pencil doctrine."

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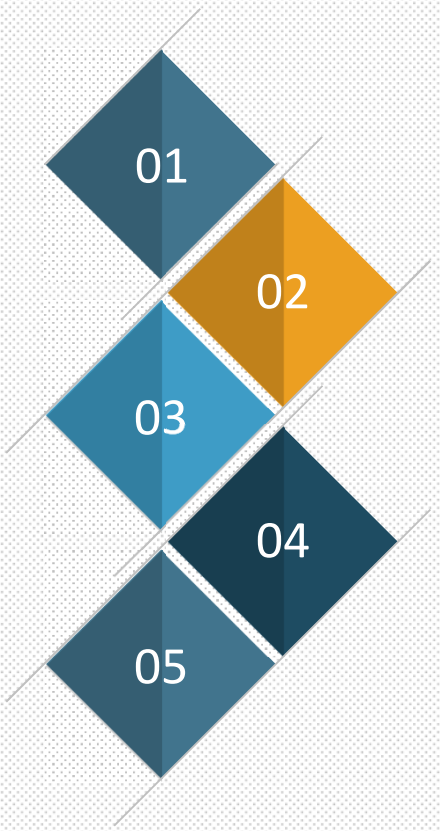
Federal Non-compete Reform?

Workplace Mobility Act



- Introduced April 2018.
- Would have allowed workers to pursue new jobs and higher wages without fearing legal action from former employers.
- Would have prohibited the use of non-compete agreements, while still allowing employers to protect their trade secrets.
- Would have required employers to notify employees that these agreements are illegal.
- Would have allowed the U.S. Department of Labor to enforce the ban with fines on the employer.

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Federal Non-compete Reform?

Events of September 2018

- Four members of the U.S. House of Representatives released a report recommending that non-compete agreements be banned.

- FTC Commissioner Rohit Chopra made comments urging that Federal Trade Commission should write rules defining when non-compete agreements for employees are permissible.

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Federal Non-Compete Reform?

Still Trying…

- The current Congress may consider prohibiting certain non-compete agreements.
- Marco Rubio, Florida Senator, introduced a proposed amendment to the FLSA, **January 15, 2019.**
  - It would:
    - ✓ Be called the "Freedom to Compete Act"
    - ✓ Prohibit agreements between employers and most non-exempt employees restricting post-employment work
    - ✓ Render existing non-competes void and without effect
    - ✓ Not apply to employees exempt in FLSA from minimum wage and overtime requirements

- Bill has been referred to Committee on Health, Education, Labor, and Pensions.
- So far, no co-sponsors or equivalent House bill.

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Recent Restrictive Covenant Decisions

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Wisconsin Supreme Court Strikes Down Co-Worker Non-Solicitation Clause

Manitowoc Co., Inc. v. Lanning, 2018 WI 6, 906 N.W.2d 130 (Wis. Jan. 19, 2018)

- **Facts:** Manitowoc Company's chief engineer, John Lanning, resigned to join a direct competitor, SANY America.
  - He then communicated with at least 9 Manitowoc employees about potential employment opportunities at SANY.
  - Manitowoc then filed suit alleging wrongful solicitation of former co-workers in violation of a two-year non-solicitation-of-employees ("NSE") provision.
  - Lanning argued that the NSE provision is a restraint of trade governed by Wis. Stat. §103.465 (the "non-compete statute") and was unenforceable because it was overbroad.

- **Issue:** Are "non-poach" or "anti-raiding" clauses covered by Wisconsin's non-compete statute which requires that restrictions "be reasonably necessary for the protection of the employer?"

- **Wisconsin Supreme Court:** Yes; the NSE provision was unenforceable.
  - Wisconsin's non-compete statute broadly applies to restrictions on competition, including post-employment restrictions on the ability to solicit former co-workers.
  - The NSE provision was overbroad and Manitowoc does not have a protectable interest justifying the restriction imposed on the activity of the employee.

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Arkansas Appellate Decision Bolsters Enforceability of Expired Non-Competes

Bud Anderson Heating & Cooling, Inc. v. Neil, 2018 Ark. App. 183, 545 S.W.3d 819 (Mar. 7, 2018)

Facts

- In 2013, employee Mike Neil of HVAC vendor Budd Anderson Heating & Cooling ("BAHC") signed a noncompete agreement restricting him from competing in four counties for 12 months after the termination of his employment with BAHC. ▪ In 2016, Neil resigned to join a competitor of BAHC located within BAHC's territory and subsequently solicited a BAHC customer to be serviced by Neil's new employer. ▪ BAHC then sought a one-year prospective injunction seeking to enforce the expired noncompete agreement.

Issue

Can courts extend non-compete restrictions beyond the expiration of the contractual non-compete period?

Arkansas Appellate Court: Yes. Extension of a noncompetition period is within a court's broad equitable powers.

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"Janitor Problem" Sinks Illinois Non-Compete

***Medix Staffing Solutions, Inc. v. Dumrauf*, 2018 WL 1859039, 2018 U.S. Dist. LEXIS 64813 (N. D. Ill. Apr. 17, 2018)**

- Court invalidated a restrictive covenant that prohibited defendant's employment in any capacity at another company in the same business – the defendant argued that the restrictive covenant "would bar him from even working as a janitor at another company."

- Court declined to modify overbroad restrictive covenant determining there is "no factual scenario under which it would be reasonable."

- **Take away:** Employers should make sure their non-competes are drafted as narrowly as possible to meet their needs – and not be so broad as to even bar an employee from working as a janitor for a competitor.

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Ninth Circuit Clarifies Law

Golden v. Cal. Emergency Physicians Med. Grp., 896 F.3d 1018 (9th Cir., Jul. 24, 2018)

- **Facts:** Doctor sued former employer for various causes of action, including alleged employment discrimination based on race. ▪ After reaching an oral settlement agreement in open court, Doctor refused to sign a written settlement agreement that included a provision prohibiting him from working: (A) for the former employer; or (B) at any facility it may own or with which it may contract in the future.

- **Issue:** Did the "no future employment" clause violate § 16600 of the Cal. Business & Professions Code, which invalidates "every contract by which anyone is restrained from engaging in a lawful profession, trade, or business of any kind …"?

- **Ninth Circuit:** Yes, in part. ▪ The prohibition on future employment at facilities owned or managed by the former employer did not impose a substantial restraint and was therefore acceptable. ▪ However, a prohibition on employment with third parties who contracted with the former employer was overbroad because it was a substantial restraint on the lawful practice of medicine.

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California Appellate Court Invalidates Non-Solicit of Employees

AMN Healthcare, Inc. v. Aya Healthcare Servs., Inc., 28 Cal. App. 5th 923 (Cal. App. Nov. 1, 2018)

Facts: AMN and Aya are competing healthcare staffing companies that provide travel nurses to medical care facilities throughout the country; the individual defendants were former travel nurse recruiters of AMN who left AMN and joined Aya, where they also worked as travel nurse recruiters. ▪ Individual defendants signed NDAs with AMN, containing a one-year NSE provision. ▪ After individual defendants resigned, AMN sued them for, *inter alia,* violating the one-year NSE provision. ▪ Defendants filed a cross-complaint, requesting the court to declare the NSE void and enjoining AMN from enforcing the provision against other former AMN employees.

Issue: Did the non-solicitation clause violate Cal. Business & Professions Code § 16600, which invalidates "every contract by which anyone is restrained from engaging in a lawful profession, trade, or business of any kind …"?

California Appellate Court (4th Dist.): Yes.

- The prohibition was void under §16600 – it restrained individual defendants from practicing their chosen profession (*i.e.,* recruiting travel nurses).
- The court also affirmed the injunction, which prevented AMN from enforcing any contract in California purporting to restrain its former employees from soliciting any employee of AMN to leave the service of AMN.

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State and Federal Courts In Illinois Remain Split Over Required Consideration

- In *Fifield v. Premier Dealer Servs., Inc.*, 2013 IL App (1st) 120327, 993 N.E.2nd 938 (Ill. App. Ct.), *appeal denied,* 2013 Ill. LEXIS 883 (Ill., Sep. 25, 2013), the Illinois Appellate Court held that, absent other consideration, there must be two or more years of employment after signing a restrictive covenant for there to be adequate consideration. Since that decision, Illinois state and federal courts split on whether to follow *Fifield,* and they remain split:

> *Indus. Packaging Supplies, Inc. v. Channell,* 2018 WL 2560993, 2018 U.S. Dist. LEXIS 93598 *(N.D. Ill. Jun. 4, 2018).*
>
> "My prediction is that the Illinois Supreme Court would reject the bright-line two-year rule in favor of a fact-specific approach."

> *Automated Indus. Mach., Inc. v. Christofilis*, 2017 IL App (2d) 160301-U (Ill. App. Ct. 2017), *appeal denied,* 2018 Ill. LEXIS 246 (Ill., Mar. 21, 2018).
>
> "We acknowledge that there is a possibility that our Supreme Court will reject a two-year bright-line rule in favor of a more fact specific rule."

- Until the Illinois Supreme Court weighs in, prudent employers will provide consideration in addition to mere continued employment.

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Developments in Trade Secrets

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Massachusetts Becomes 49th State to Adopt Uniform Trade Secrets Act

Massachusetts H. 4868

- Massachusetts joined 48 states by adopting the Uniform Trade Secrets Act (UTSA), effective October 1, 2018
- Now, New York is the only state not to have adopted the UTSA
- Enacted in same legislation with Massachusetts Noncompetition Agreement Act
- Effective October 1, 2018

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Massachusetts UTSA

Key Points

- Protects trade secrets that offer actual or potential economic advantage to their owners – prior law protected trade secrets that were in "continuous use" within a business, and "potential economic value" of a trade secret was unlikely to warrant protection.
- Allows courts to enjoin "[a]ctual or threatened misappropriation" of trade secrets.
- Eases the burden on defendants in recovering fees for defending bad-faith trade secrets claims.
- The Massachusetts law is similar to the Defend Trade Secrets Act but has a few differences:
  - Ex parte seizures are only available under DTSA
  - MA does not require disclosures about whistleblower immunity before attorney's fees may be awarded

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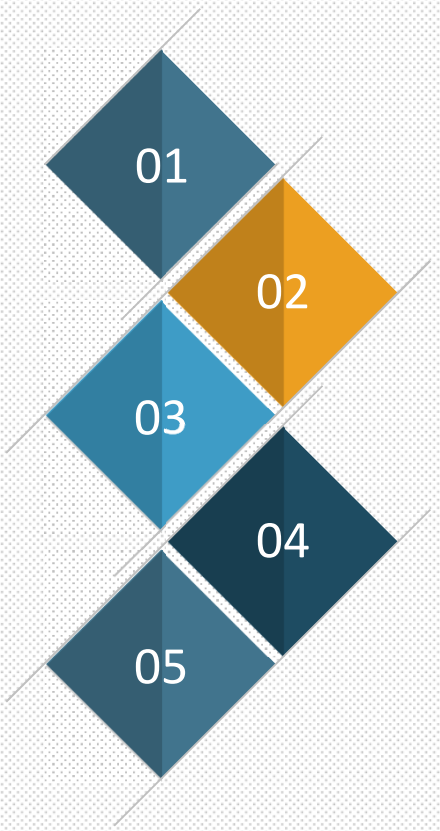
Defend Trade Secrets Act of 2016

What's New?



- Since the Defend Trade Secrets Act (DTSA) was passed in the spring of 2016, the number of civil trade secrets cases filed in federal and state courts in the United States has increased by 30%.
- Many of these are filed in federal court.
- (DTSA granted original federal court jurisdiction for all trade secret misappropriation cases, where it did not exist before.)
- Private litigants will continue to seek the protections provided under DTSA to protect their trade secrets.
- Pleading is key: Plaintiffs must adequately allege that they took reasonable steps to maintain the secrecy of protected information.

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Defend Trade Secrets Act of 2016

Immunity for Whistleblowers 18 U.S.C. §1833(b).

***Christian v. Lannett Co., Inc.*, No. CV 16-963, (E.D. Pa. Mar. 29, 2018).**

- For the first time, a whistleblower was granted protection under the immunity provision of the Defend Trade Secrets Act (DTSA).
- Terminated manager brought discrimination claims against employer under various federal statutes.
- Employer counterclaimed, including a DTSA violation, alleging the plaintiff retained company trade secrets and made improper disclosure of some of those secrets to her attorney and disclosed those trade secrets in violation of the DTSA.
- HELD: The court granted immunity to the terminated manager. The disclosure (which was made pursuant to a court order) was consistent with DTSA's immunity provision, which allows a whistleblower to disclose trade secrets "in confidence… to an attorney … solely for the purpose of reporting or investigating a suspected violation of law."

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U.S. Department of Justice "China Initiative"

- Announced November 1, 2018.
- Response to rapidly increasing Chinese economic espionage against the United States.
- Senior leadership in DOJ, FBI and U.S. Attorneys will work together.
- Components include:
  - Identify priority trade secret theft cases, ensure that investigations are adequately resourced; and work to bring them to fruition in a timely manner and according to the facts and applicable law.
  - Develop an enforcement strategy concerning non-traditional collectors (e.g., researchers in labs, universities, and the defense industrial base) that are being coopted into transferring technology contrary to U.S. interests.
  - Identify opportunities to better address supply chain threats, especially ones impacting the telecommunications sector, prior to the transition to 5G networks.

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New York Court Limits Scope of Damage Awards in Trade Secret Actions

E.J. Brooks Co. v. Cambridge Sec. Seals, 31 N.Y.3d 441 (May 3, 2018)

- **Facts:** Plastics manufacturer sued competitor for misappropriation of trade secrets, unfair competition and unjust enrichment.
- **Issue:** Whether a plaintiff can recover damages measured by the costs the defendant avoided by misappropriating trade secrets (e.g., R & D costs)?
- **NY Court of Appeals:** No. The calculation of damages must be narrowly focused on the economic injuries incurred by plaintiff, rather than on the costs avoided by the defendant.
- **Note:** Other jurisdictions have come out the other way on this issue.

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Scrutiny of No-Poach Agreements

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No Poach Agreements

Federal Scrutiny

- "Antitrust Guidance for Human Resources Professionals" published by U.S. Department of Justice, Antitrust Division, jointly with Federal Trade Commission, in October 2016
- Guidance is being followed by current Administration

Prohibited Conduct

- **Wage-Fixing Agreements** – inter-company agreements regarding employee salary or other terms of compensation, either at a specific level or within a range.
- **No-Poaching Agreements** – inter-company agreements to refuse to solicit or hire the other company's employees.

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No Poach Agreements

Possible Consequences of Violations

- Criminal prosecution by DOJ against company, individual employees, or both.
- Civil enforcement actions by DOJ and/or FTC.
- Actions by state Attorneys General.
- Civil lawsuits by harmed employees/private parties (which could include treble damages and attorneys' fees).

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No Poach Agreements

Red Flags

- Guidance includes red flags likely to cause antitrust concerns.
- Companies, managers, and human resource professionals should not:
  - Agree with another company about employee salaries or other forms of compensation, either at a specific level or in a range;
  - Agree with another company to refuse to solicit or hire that company's employees;
  - Agree with another company about employee benefits or other terms and conditions of employment;
  - Express to another company that the companies should not try too aggressively to hire each other's employees;
  - Exchange company-specific information about employee compensation or other terms and conditions of employment ;
  - Discuss any of the above topics with colleagues at other companies – even in social settings, and including being present at meetings where such topics are discussed;
  - Receive documents or information from another company containing internal, company-specific, compensation or other information concerning terms and conditions of employment.

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No Poach Agreements

Red Flags

- The red flags identified by the DOJ and FTC are not exhaustive.

- On the other hand, engaging in conduct that would be considered a red flag does not mean an antitrust violation has occurred.
  - *For example, it may be permissible to have an agreement not to solicit another company's employees if it arises in the context of a larger, pro-competitive arrangement.*

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No Poach Agreements

- April 2018 – DOJ settled a civil suit it brought against rail equipment companies who for years had unlawful agreements not to compete for each other's employees.
- *United States v. Knorr-Bremse AG and Westinghouse Air Brake Technologies Corp*.
  - German company and Delaware company, whose subsidiaries are direct competitors in portions of manufacture of train and vehicle equipment market
  - Agreed not to hire each other's employees, in clear violation of Section 1 of the Sherman Act
  - Settlement deemed appropriate, in part, because conduct took place some years before guidance was issued
  - Settlement included:
    - Fines
    - Future self-reporting requirements by companies
    - Future invasive scrutiny by DOJ

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Practical Tips and Advice

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Tips and Practical Advice

Review your agreements and procedures

- Carefully analyze needed protections
- Evaluate any non-compete agreements to match needs.
  - Ensure that duration and scope are narrowly tailored
  - Consider relying on non-solicit and confidential information clauses instead of non-competes
  - Consider adopting garden leave, rather than non-compete, approach
- Establish and follow procedures to protect confidential information
- Immediately investigate potential confidentiality breaches
- Avoid no poach agreements, communications with competitors about employee compensation, or other arrangements with competitors for employees that could have a tendency to unlawfully chill employee movement or depress wages

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Questions?

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Non-Compete and Trade Secrets Developments and Trends: A Year in Review and Looking Forward

Webinar

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