IT UP

Proposed FTC rule change for non-compete agreements has trade secret attorneys planning for the future

By John McNally

The Federal Trade Commission is in the process of making changes to its rule for non-compete clauses. The commission posted its proposal Jan. 5 and opened it up for public discussion. According to legal experts, the change isn't likely to go into effect until April 2024. It could even face court battles.

Along with its proposed rule change, the FTC provided supplemental information which states:

"The Commission is not aware of any evidence of a relationship between the enforceability of non-compete clauses and the rate at which companies make other types of productive investments, such as investments in creating or sharing trade secrets. Similarly, the Commission is not aware of any evidence non-compete clauses reduce trade secret misappropriation or the loss of other types of confidential information. The Commission's understanding is there is little reliable empirical data on trade secret theft and firm investment in trade secrets in general, and no reliable data on how non-compete clauses affect these practices. The Commission understands these are difficult areas for researchers to study, due to, for example, the lack of a governmental registration requirement for trade secrets and the unwillingness of firms to disclose information about their practices related to trade secrets."

But trade secret attorneys who counsel companies in protecting their most valuable information are already preparing for possible changes. Locke Lord partner Jennifer Kenedy said that if the courts enact and affirm the rule, attorneys and companies will lose a tool for protecting trade secrets. It also could start a run of job migration that will have to be addressed by employers.

"Without non-competes, competition will increase, which is sort of the policy behind the (FTC) ban," she said. "More employees will leave companies for competitors and probably will feel emboldened to take or use trade secrets when they do."

She added: "Even without the non-compete to enforce, we're telling companies (they) still have other tools (to use) to protect their trade secrets. They have the Uniform Trade Secrets Act and the federal Defend Trade Secrets Act. They both remain viable options to enforce their trade secret rights."

Kenedy and Neal Gerber Eisenberg's Olivia Luk Bedi agree that companies should reinvest and place tougher scrutiny on protection of their trade secrets. Kenedy believes updated employee confidentiality and technology-use policies that protect trade secrets are a starting point.

"There also has to be a focus on higher-level employees that companies can demonstrate have repeated access to those identified trade secrets," Kenedy said.

Bedi adds that basic elements of security such as locks, limiting password distribution and enhancing watermarks on documents are especially important since most people have access to camera phones.

"Anything you can describe to a court, should you find yourself in litigation, is a good thing," Bedi said of actions taken to protect trade secrets.

Bedi also suggests that companies host biannual meetings with their attorneys to discuss non-competes and trade secret protection.

"If there are existing non-compete clauses … I (advise the client) that we should go back and analyze them to ensure that they're complying with the current state law," she said. "Not everyone wants to do this. They don't want to spend the money for regular tune-ups. The discussion of potential or existing trade secrets (should happen) annually or every other year."

Jennifer Kenedy

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Kenedy said the FTC has made it clear that if an employer has developed broad non-disclosure or non-solicitation agreements, the commission considers those to be "a de facto non-compete agreement."

"(If it is) preventing employees from working in their chosen profession, those will be invalidated as well," she said. "That's another hurdle that's on the horizon (and) companies need to be prepared with narrowly tailored non-disclosure(s) and non-solicitation(s)."

CONFIDENTIAL INFORMATION VS. TRADE SECRETS

Jenner & Block partner Debbie Berman bluntly states that it won't "cut mustard" in court if a company claims its confidential information to be trade secrets. But the line between what constitutes a trade secret and confidential information can be murky, according to the attorneys.

Kenedy claims that probably the greatest trade secret in the world is Coca-Cola's formula. But an important list of deep-pocketed customers in the market for a company's product may not — but could — rise to trade secret level.

"If that customer list identifies very wealthy people who are in the business for a particular kind of tax tool, for example, and you only know that particular population is in the market for that particular tax tool or tax advice, that could become a trade secret because you only learned about that list by virtue of your employment at this tax consulting company," she said.

Kenedy says the difference derives from independent economic value of being a secret.

"If it fell into the hands of the competitor, they would get a significant competitive advantage because they did not put in the same amount of time, effort, and money to develop that information and would just be able to use it for free," she said.

Companies should make the effort to differentiate between confidential information and trade secrets, Kenedy declared. Trying to protect it through a non-disclosure agreement could fail.

"That isn't necessarily going to be successful if you're filing a Uniform Trade Secret Act case or a federal Defend Trade Secret Act case," she said. "You have to prove the elements of a trade secret, which is the independent economic secret, independent economic value, and that you took reasonable measures to protect it."

Berman believes a non-solicitation agreement for departing employees can be an effective method for protecting trade secrets, but they should be tailored to be narrow. She has seen many broad non-solicit deals falter.

Debbie Berman

"If they're narrowly crafted, those seem defensible to me and they seem smart," she said. "Again, the FTC may throw a wrench into that, but I think the other confidentiality agreements, as long as they're reasonable and identify the business need for why the information needs to be kept confidential, work."

She's also seen positives in providing "garden leave" — paying departing employees to not work for a period of time.

"That seems less offensive … because you're not keeping someone from earning a living, they're actually getting paid," she said. "Which goes to the point … what is it you want to protect and who are you worried about? Because you're not going to pay every employee their salary when they leave. That's just not practical."

ENFORCEMENT ACTIONS

Kenedy said the FTC has filed multiple enforcement actions since it proposed its changes to non-compete rule, even while it's still pending.

"What they're doing is filing enforcement actions against companies who they think their non-competes are unfair competition," she said. "They're issuing orders on them and requiring those companies to give notice to employees for the next 10 years that they're not subject to a non-compete if the (employees) were under the impression that they were."

Kenedy said the FTC can be aggressive in its pursuit of employers who target entry-level employees with non-compete agreements.

"(They see it) as an overreach and they will go after these companies," she said, "and come up with remedies that are onerous on the company in terms of protecting their intellectual property assets."

Berman has worked in trade secret law for more than 30 years and remembers when it was easy to enforce non-compete agreements. "When I started it was (a) very pro employer (environment)," she said. "In Illinois, you've seen this change over time."

She's been surprised to see other pro-employer states such as New York ("the center of Wall Street," she notes) and Delaware have had anti non-compete legislation move through the legislature.

"There is more of skepticism about non-competes. That's really the biggest change that I've seen," she said.

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