What does FTC ban on noncompete agreements mean for companies' ability to protect trade secrets?

By Matthew D. Kohel, Esq., and Dana Silva, Esq., Saul Ewing LLP

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On April 23, 2024, the Federal Trade Commission (FTC) issued its proposed final rule (the "Rule") banning the use of future noncompete agreements for all workers, including senior executives, 89 FR 38342 (https://bit.ly/3UUYyQU).

Absent noncompetes, the importance of having employees sign a strong confidentiality or non-disclosure agreement, and in some cases, a nonsolicitation agreement, cannot be understated.

Noncompete agreements have long been a valuable tool in a company's toolbox to mitigate the risk of a former employee disclosing or using company trade secrets. Although recent lawsuits against the FTC will likely delay the enactment of the Rule, given the number of states that have already adopted some type of restrictions on noncompetes, companies should continue to rely on other measures to protect their confidential and trade secret information.

How does the FTC's new rule affect trade secrets?

Generally, noncompete agreements restrict an employee's ability to work for a competitor for a specific period of time after his or her employment ends. While not directly addressing the goal of protecting a company's trade secrets, noncompetes can help prevent former employees from disclosing or using the company's trade secrets for the benefit of his or her new employer. Noncompete agreements can be especially useful for companies whose non-public proprietary information is valuable and strategically significant, as well as in emerging fields such as artificial intelligence and biotechnology where competition for top talent is fierce.

Legally speaking, after an employee who has signed a noncompete agreement leaves his or her employment and joins a competitor, a company can choose to bring a lawsuit for breach of contract. A claim for breach of a noncompete agreement, if proven, can provide a basis for injunctive relief, giving a company a fast and effective remedy. And unlike a misappropriation of trade secret claim, a claim for breach of a noncompete agreement does not require a company to prove the existence of its trade secrets.

It is worth noting that trade secrets and confidential information are not one and the same. That is, confidential information is broader than and may encompass trade secrets; but not all confidential information may constitute trade secrets. This is important because the protection of confidential information is a creature of contract and most states do not recognize a non-contractual claim for misappropriation of confidential information that does not rise to the level of trade secrets.

For these reasons, the relative simplicity of enforcing noncompete agreements has made it a highly favored tool for companies to protect their trade secrets and sensitive confidential information.

How can companies protect trade secrets without noncompete agreements? The best defense is a good offense

Without the availability of a claim for breaching a noncompete, what other steps can a company take to protect its confidential material and trade secrets? Absent noncompetes, the importance of having employees sign a strong confidentiality or non-disclosure agreement ("NDA"), and in some cases, a nonsolicitation agreement, cannot be understated. These agreements impose similar obligations as a noncompete by protecting against potentially harmful competition by a former employee, but with a more narrowly tailored focus on protecting the company's confidential and trade secret information.

But companies should beware that the Rule bans any agreement that acts as a de facto noncompete regardless of its name. Instead, companies should draft agreements containing specific language focused on the protection of its confidential and trade secret information.

Companies should also bolster the effects of an NDA by implementing a robust trade secret management program that includes hiring and training procedures aimed at educating employees on the importance of protecting the company's confidential and trade secret information.

For example, do employees understand why they are signing an NDA or understand when they should obtain one from a third party

if they are engaging in preliminary discussions with a potential project partner? Are employees able to articulate what confidential materials they use in the course of their job? Do employees understand the risk of commingling the company's confidential material with their personal data by utilizing work devices on a home network or on a personal device?

Emphasis should also be placed on training throughout employment to reaffirm company policies surrounding trade secrets.

Lastly, a company should also have policies in place addressing the return of company property and data upon an employee's exit. And, if all else fails, the company should have the ability to remotely wipe company devices in the event of an uncooperative former employee.

Having strong and effective policies for an employee's departure could prevent any misappropriation before it happens. Upon their exit, employees should also be reminded of their contractual obligations to maintain confidentiality and not to disclose the company's trade secrets in the future.

Suing for trade secret misappropriation

In the Rule, the Commission acknowledged the various concerns raised about the effect on trade secrets from banning noncompetes, but noted that employers can still protect their investments by relying on patent law, NDAs, and trade secret laws.

There are many federal and state laws under which trade secret owners can sue for misappropriation. Specifically, trade secret owners can seek relief under the federal Defend Trade Secrets Act ("DTSA") and/or assert claims under state law, which is likely some version of the Uniform Trade Secrets Act ("UTSA"). A trade secret plaintiff may seek an injunction under these laws to preclude actual or threatened misappropriation of trade secrets.

In some jurisdictions, a plaintiff may even be able to enjoin the former employee from taking on certain duties for a competitor where disclosure of the company's trade secrets in the employee's new position is "inevitable." Since injunctions are frequently sought against former employees, these individuals will often consent to injunctive relief rather than battle their former employer in court.

Yet, any seasoned practitioner will agree that trade secret litigation is generally not cut-and-dried and can present challenges for plaintiffs. Among other things, the plaintiff will bear the burden to demonstrate that its confidential information qualifies as trade secrets under the law. This will involve the company proving that it took reasonable measures to keep the information secret and that the information provides a competitive advantage by being kept from the competition.

Meeting these requirements can be evidence-intensive and expensive, especially if the case becomes a battle of the experts. In addition, companies might balk at the prospect of having to identify their trade secrets in litigation, even if they are disclosed under a protective order or in a limited form. Also, it is worth noting that the damage awards in trade secret cases vary greatly and historically have been smaller than the amounts given out by juries in successful patent infringement cases, although there are exceptions such as the $2 billion in damages awarded in *Appian Corp. v. Pegasystems Inc.*, No. 2020-07216 (Va. Cir. Ct. Fairfax Cty. May 9, 2022). Courts have significant flexibility in trade secret cases to fashion damages awards under an unjust enrichment theory.

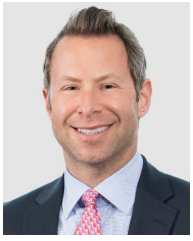
Welcome to the club, says California, Minnesota, North Dakota and Oklahoma

The FTC's recent ban was not exactly news for companies operating in California, Minnesota, North Dakota, and Oklahoma. These states have already banned noncompete agreements. Many more states have enacted restrictions on noncompete agreements.

One possible effect of the FTC's ban on noncompetition agreements is an increase in trade secret litigation. In California, the home of some of the harshest criticism of noncompetes, over 600 trade secret cases were filed between 2018 and 2022 in the Central and Northern Districts of California, according to The Lex Machina 2023 Trade Secret Litigation Report (July 13, 2023). The large number of cases filed in these courts is primarily driven by a combination of the enactment of the DTSA in 2016, California's stance on noncompetes, as well as the high concentration of employees in competitive industries, such as technology and life sciences, according to the report.

Should the Rule be enacted and noncompete agreements banned for good, companies should be prepared to reevaluate the reasonable measures they use to protect their trade secrets and the language of their NDAs to ensure that they do not violate the Rule by acting as noncompetes.

About the authors



Matthew D. Kohel (L), a partner in **Saul Ewing**'s Baltimore office, represents clients in commercial litigation, intellectual property matters, and data privacy issues. His intellectual property experience includes claims for the misappropriation of trade secrets, trademark infringement, false advertising, the sale of counterfeit goods, and cases involving a variety of patent issues. He can be reached at matthew.kohel@saul.com. **Dana Silva** (R), counsel in the firm's Los Angeles office, handles business litigation and general civil suits. She has experience with breach of contract, fiduciary duty, trade secret disputes, fraudulent conveyance, unfair competition and shareholder disputes, among other matters. She can be reached at dana.silva@saul.com.

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