Business Better (Season 3, Episode 12): Protecting Your Business from Theft of Trade Secrets, Loss of Customers, and Employees Being Hired Away

Speakers: Jay Zweig, Leslie John, Mitchell Turbenson

Steven Burkhart:

Welcome to Business Better, a podcast designed to help businesses navigate the new normal. I'm your host, Steve Burkhart. After a long career at global consumer products company BIC – where I served as Vice President of Administration, General Counsel, and Secretary – I'm now Special Counsel in the Litigation Department at Ballard Spahr, a law firm with clients across industries and throughout the country.

In today's episode, we discuss what employers, in-house counsel, HR Departments, and business owners need to know about effective confidentiality and non-solicitation agreements, and the future of non-compete agreements. Leading this discussion is my Ballard Spahr colleague, Mitch Turbenson, an Associate in our Litigation department. Mitch is joined by Leslie John, and Jay Zweig, both of whom are Partners in our Litigation department; and who focus their practices on antitrust and employment law matters. So now let's turn the conversation over to Mitch.

Mitch Turbenson:

Thank you for joining us for an episode of Ballard Spahr's podcast. Today's episode is entitled, Protecting Your Business from Theft of Trade Secrets, Loss of Customers and Employees Being Hired Away. My name is Mitch Turbenson. I'm an attorney in Ballard Spahr's Phoenix and Los Angeles offices, and I will be the host for today's discussion. With me is Leslie John, who is the practice leader of Ballard Spahr's, antitrust and competition group and co-leader of Ballard Spahr's false advertising litigation team. Leslie is stationed out of Ballard Spahr's Philadelphia office. Hi Leslie.

Leslie John:

Hi Mitch. Glad to be with you today.

Mitch Turbenson:

Glad to have you. Also with me is Jay Zweig, who is a partner in Ballard Spahr's Phoenix office and practices employment law and commercial litigation. Hey Jay.

Jay Zweig:

Hi, Mitch. Good to be joining you and Leslie.

Mitch Turbenson:

Great to have you too. In this episode of Ballard Spahr's podcast, we will first be discussing the general methods employers use to protect their business interests. Second, we'll be serving the trends of enforceability of non-compete and related agreements used to protect business interests including the proposed FTC rule. And third, we'll provide some general guidance for protecting business interests in light of a radically shifting enforcement landscape. So without further delay, let's dive in. Jay, can you give me a description of the types of agreements you typically see businesses utilized to protect their business interests?

Jay Zweig:

There are several types of agreements that we see and work with for clients to adopt and sometimes to enforce. The first are non-compete agreements. They could also be called fair competition agreements. These are agreements that preclude an employee from competing while they're employed and also restrict them within a reasonable geographic area for a reasonable amount of time and also a reasonable description of what they're not permitted to do for a post-employment period. Those are the non-compete agreements. We'll be talking more about those. The next are garden leave clauses. You can think of these as non-compete agreements, but you are paying the former employee to sit on the bench. The British terminology would be without an accent, "Go tend to your garden instead of working for a competitor." Those are garden leave clauses and we find that courts look favorably on those because the employee is getting paid not to compete.

The next are confidentiality and non-disclosure agreements. Sometimes these are looked at as non-compete agreements if they're too broad. But in general they require an employee both during and after their employment, not to use or disclose confidential information that they obtained during their employment. And it could be about their company. It also could be about customers of the company and other subjects. Again, these must be reasonably drafted and compliant with current law. The next category are non-solicitation agreements, and those are what they say, don't solicit or do business with customers of your former employer either during the employment or post-employment. Companies use these to protect their customer base. There are also similar non-solicitation, and these are also thought of as no hire agreements. And this will have some antitrust implications.

Leslie will speak about this, but basically they say "If you leave to go to a competitor, don't bring your coworkers with you. Don't solicit them and don't hire them." So these are the general agreements. There's also subcategories that have claw-back features or forfeiture if you violate these agreements where the company would take back stock options or take back a bonus or part of compensation. And Mitch, this is a general review of the types of agreements that we draft for clients and also the kinds of agreements that we review in the marketplace when clients come to us with questions.

Mitch Turbenson:

Thank you for that great overview, Jay. And Leslie, I know these agreements, as Jay mentioned, often create antitrust concerns and recently the Federal Trade Commission has weighed in with a proposed rule on non-compete agreements. Could you give us an overview of the FTCs involvement in these agreements to protect business interests?

Leslie John:

Sure, I'd be happy to. So as you mentioned, the FTC threw a wrench into things. But on January 5th, 2023, the Federal Trade Commission issued a notice of proposed rule making. And this is aimed at categorically banning non-compete agreements nationwide. If in enacted as drafted, the proposed rule would make it illegal for employers to enter into or attempt to enter into non-compete agreements with a worker, maintain non-compete agreements with a worker or represent to a worker that the worker is subject to a non-compete agreement. And I used the word worker because in fact the FTC uses that quite intentionally to propose a rule that's broader than just covering employees. And it would include as well independent contractors, interns, and even volunteers. Now, when the FTC put out this notice of proposed rulemaking, they opened it up for comment. There have been over 25,000 comments received.

The comment period is now closed. The FTC said that they would come out with a rule in about a year. So we anticipate some point around April of 2024, we will see if the in fact rule is going to be as broad as the notice of proposed rulemaking. But quite notably, when the FTC came out with this rule, it was met with a very vigorous dissent from then Commissioner Christine Wilson, who wrote that it is a radical departure from hundreds of years of legal precedent. So there's already been quite vigorous debate in the public discussion period and there will in fact probably be at the end of the day, legal challenges to this rule. But that's all to come in the future and we'll see how that shapes up.

Mitch Turbenson:

Thank you. And what about the FTCs recent enforcement activity? Have you noticed that that's ticked up a little bit?

Leslie John:

Indeed it has. And in fact, the day before the FTC came out with their proposed rule banning non-competes, the FTC took action against three different companies in connection with what the FTC thought were over-broad non-competes that various companies had. And so for instance, the FTC has announced that they will take action under Section 5 of the FTC Act, section 5 prohibits companies from engaging in unfair methods of competition. That the FTC will use what it believes its authority is under that act to take a stance that overly broad non-competes are unfair methods of competition. And this is quite consistent with what we've seen in the Biden administration where at the very beginning of the administration, they set out as a priority for antitrust enforcement looking at practices in the labor field that the Biden administration believes are unfairly impacting workers, either suppressing workers' wages and compensation on the one hand, or on the other hand prohibiting employees from as freely moving from employer to employer as they would like.

And so against this backdrop of really increased enforcement activity, we see not only the FTC taking action against what it says are overly broad non-competes on the one hand, but then also the Department of Justice Antitrust Division, in fact taking criminal actions against companies that it believes are getting together with competitors to agree not to poach each other's employees or to do things like setting employee wages. And so all of the action that we're seeing in the labor space is really in some ways a development that's very much impacting the antitrust enforcement agencies and very active postures they're taking against perceived unfair practices that they think are impacting employees.

Mitch Turbenson:

So enforcement certainly ramping up. Jay, have you seen state legislatures showing a similar disdain to non-compete agreements as the FTC has been doing?

Jay Zweig:

We have Mitch, in the last decade there have been approximately 29 states that have been chipping away at the enforceability of non-compete laws. This is a trend that's continuing. We have a bill pending before the Minnesota Governor right now that would ban most non-compete agreements effective July 1 of this year. And there've been many other states such as Colorado, Illinois, Maine, and others that are really focusing in on wage and income thresholds for workers subject to non-compete agreements. In other words, an independent contractor or an employee making less than a certain level of income could not enter into an enforceable non-compete agreement. This is what we're seeing at the state level.

Mitch Turbenson:

And how about on the federal level? Have there been any bills or anything being done aside from the FTC proposed rule?

Jay Zweig:

The Biden administration stated going in that it was hostile to non-compete agreements and one of its objectives was to see action banning these agreements. And so in the Senate and the House, there's the bipartisan Workforce Mobility Act of 2023. These would generally prohibit non-compete agreements. There are some exceptions such as the seller of a business could enter into a non-compete agreement stopping the seller from being in a similar business in the same geographic area or a partner of an enterprise upon dissolution of that corporation or partnership could also be subject to a non-compete. We're watching this legislation, these bipartisan bills have not passed. But again, you're looking at a confluence of executive branch administrative rulemaking with the FTC and the legislation through Congress all being hostile to non-competes, particularly non-competes that the administration feels are overly broad and one size fits all for all workers.

Mitch Turbenson:

So needless to say, there's a lot of uncertainty with regard to the viability of non-compete agreements. Starting with you Leslie, do you have any advice on how employers could revise or draft their agreements in a way that they remain enforceable?

Leslie John:

Yeah, I think there are a number of things that employers can do. And I think one thing for sure with the potential of an FTC ban, varying state laws that have been passed as well as a potential federal law and changes in state decisions, I think one thing that employers can do is an audit of all of the kinds of agreements that they have out there because I think we can see potentially a number of ways that all of these rules can come into play. And Jay highlighted really the range of kinds of agreements that can be impacted here. But what we see is not only do these rules potentially impact non-competes, but they can also impact quite frankly non-solicitation agreements as well as non-disclosure agreements that are drafted so broadly that they would be interpreted as what the FTC calls de facto non-competes.

So I do think looking at that very broad array of agreements that a company may have in place, which ones of those do we think are safe from challenge going forward, and which ones are potential risk areas and areas for companies to consider going forward, whether they want to change their practices. And again, I would say the very first place to start is where there are very broad non-competes and potentially the kinds of non-competes that cover all classes of employees.

Because that's the example where we've seen already the FTC take action against companies utilizing Section 5 at the FTC Act is especially non-competes covering what are thought to be either workers that are not highly paid and/or workers that are not thought of as having access to trade secrets and other kinds of intellectual property that there may be an enhanced need to protect. So really looking at, has a practice been to really cover each and every employee with a non-compete that's really not varying in accordance with perhaps the compensation and expertise that that particular employee may have. So those are kind of a couple of, I think things that in an audit of all these agreements, employers really need to be attuned to.

Mitch Turbenson:

That's a great piece of advice and it really reminds me of some enforcement action even being taken by county prosecutors and state attorneys general, including the Jimmy Johns case in Illinois where you had sandwich artists that were subject to non-compete agreements. And even though I believe the evidence there was Jimmy Johns hadn't actually enforced it, the effect of just being under a non-compete agreement on the employees was enough to draw the attention of a state attorney general. Jay, how about, do you have any advice for employers who are looking with a lot of dread and uncertainty at the current legal landscape and are wanting to nonetheless protect their business interests?

Jay Zweig:

Mitch, my general advice falls into the category of make sure that your agreements are consistent with the current state of the law. You and I and our colleagues get involved on a weekly basis in examining and reviewing these agreements, sometimes sending letters to remind people of their obligations, sometimes going into state or federal court and asking a court to halt that behavior to enter an injunction. And what we see unfortunately too often is that the agreements are not up-to-date. Maybe the employer can't locate a signed a copy of the agreement. There's some question as to whether the agreement is overly broad and unenforceable. And you mentioned, and Leslie also noted that these agreements, even if an employer chooses to not take everyone to court, do have a deterrent effect on employees doing something that they shouldn't do. So again, my general advice is take a look, do an inventory.

Leslie used the word audit, which is a good one. Take a look at what agreements you have and what your processes and procedures are when either onboarding an employee who might be subject to one of these agreements or doing a transition when an employee is leaving the company to remind them about their obligations under the agreements. And there's a lot that we can do based on recent case law and anticipating where this administration is going and state governments are going to make sure that the agreements are more likely to be enforced and more likely to have a deterrent effect if that departing employee goes to their own lawyer and says, "Is this going to hold up?"

Mitch Turbenson:

And I'm opening it up to either Jay or Leslie. Are there things that employers can do that are not agreement related, that are just general best practices for employers to implement?

Jay Zweig:

Well, Mitch, I'll take that one. Again, I think just as there's a new hire checklist at most companies, number one, the new hire checklist should include did the employee acknowledge receipt of a confidentiality agreement and any non-compete or other restrictive covenants, do we have that? Also during the employment, what is the company doing to monitor its confidential information to protect the security of its computer systems and to get an alert if an employee is downloading, emailing, doing things of that nature.

Anecdotally, we had a situation this week where an employee got a little ambitious and downloaded over 2000 files from the company onto a flash drive. The employer got an alert from their IT department on this, and the employer was able to step in and say, "You cannot do that." And they were able to retrieve that flash drive. So having IT systems and educating your IT people and also making sure that if employees are using personal devices or Gmail or things of that nature that the company has procedures around that. So monitoring that type of email traffic.

And then the final thing, again, we talked about this, but when an employee leaves, before they do something, have a letter that goes to them with a copy of the restrictive covenants, the non-compete, the confidentiality agreement, have that ready to go saying you wish them well, but you also insist that they honor those post-employment obligations. Those are the primary things that we see that really make a difference. And Leslie, you may have some things that you would add for employers.

Leslie John:

Thank you. One thing I would add is this is really a fast moving area of the law and one I think to really be paying attention to and being proactive, non-competes and various kinds of agreements require consideration to be effective. So normally that's given in the context of maybe giving a bonus or some sort of annual payment to an employee.

And so to some respects, we have to anticipate changes in the law moving forward. And it does take time to effectively craft and change one's agreements as this landscape is changing and to be able to roll them out and have them be effective moving forward. So I do think this is an area of the law that it makes sense to check in on. And as you're approaching various junctures where you may be giving employees bonuses, if you need to be making changes to the agreement, that's the time to be thinking about doing it. And so it's sort of one of these areas where it's not just you do the agreement, you sit it on a shelf and wait for any undetermined period. You really need to be looking at these on an ongoing basis and looking at what kind of changes you need to protect your business going forward.

Jay Zweig:

And Mitch, one other thing that I might add just as a resource for our friends and clients is we post regular updates on our employment law blog about developments with the FTC, different state law developments. That address is www.hrlawwatch.com, hrlawwatch.com. We post regular updates on developments in non-compete and other employment laws.

Mitch Turbenson:

That is a great resource Jay. One thing I wanted to discuss that Jay, you kind of alluded to is an employer who wakes up to an essential nightmare. You have, as you referenced, a employee who is taking or sending to a personal email account or downloading thousands of emails with client information or any other kind of confidential trade secret related information. And obviously the point for lawyers that came into drafting everything and trying to protect those business interests has passed. And now you have a situation where someone is just ignoring those agreements, even the ones that are undisputedly enforceable. Where do you or other attorneys at Ballard come in and how can you assist employers in that situation?

Jay Zweig:

Mitch, there's really two things. Number one, we strongly encourage our clients to reach out to customers and try to find a business solution. In other words, if you have a departing employee who's been the so-called face of the company and they have had most of the interaction with clients that they're trying to take or information related to trade secrets or other matters, the best solution is going to be one where the client can reassure their customers that their account is being attended to, their

business is valued, and although their past contact is no longer with the company, there will be no interruption of service. So we really look for our client to do what they can and find a business solution. Simultaneously, however, we want to work with our client collaboratively and put a stop to what the former employee is doing wrongfully either with our client's confidential proprietary trade secret information or simply just in violation of a non-compete or non-solicit that the former employee has signed.

And really what we do there is we put the ex-employee and their new business partners or employer on notice that they are violating an agreement that is valid and enforceable. We see if that will have an effect. Sometimes it does. Sometimes the new employer had no idea that this ex-employee is engaged in wrongful conduct. Sometimes that could solve the problem. But the other critical thing is if we have to go into court and get an order halting the ex-employee and halting those people like the new employer or new business partners capitalizing on an unfair head start that this ex-employee has gotten, we need to do that quickly and efficiently. And that's what we do because we're seeking not just monetary damages for provable loss of business, but we're seeking an injunction, an extraordinary remedy, a court order saying that the ex-employee and the new employer have to stop.

What courts look at in those situations is, did the former employer act promptly? Is the former employer showing reasonable conduct under the circumstances where we're going into court saying "There is immediate and irreparable harm going on here, judge, and you need to stop it." So it's extremely important that action be taken, documented, and followed through with very quickly. The longer you wait, the less likely it is that a court will enter an injunction. And Mitch, you've been in on many of these cases and led many of them. What would you advise an employer in these kinds of situations?

Mitch Turbenson:

The best advice I've always used for individuals who are not yet in this position is documentation, documentation and documentation. So many times we have employers who don't even know their data systems. They don't know how to determine what was taken. They don't even know how to determine if anything was frankly taken. And without any of that evidence but just a hunch, you won't get a court to lift a finger. And so I really believe a strong IT staff and a strong IT department and the ability to track loss, loss of client information, loss of intellectual property is really key for all of that.

Well, I believe we're out of time. I want to thank Leslie and Jay for joining me. If you have questions about protecting your business interests or any of the topics discussed today, please reach out to Leslie John or Jay Zweig. And I want to thank all of our audience for listening into this episode of Ballard Spahr's podcast.

Steven Burkhart:

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