Podcast Transcript

The Emerging New Era for Noncompetes and Trade Secrets: Yesterday, Today, Tomorrow

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Rubenking: The restriction and legislation of noncompete agreements is gaining traction around the country. In July, President Biden signed an executive order that discussed the regulation of noncompete agreements, which in the past has only been the province of the states.

To stay ahead of the game, both employers and executives need to know what changes to expect and how to best prepare for the future. To help bring all this into focus, we've created a six-part series called "The Emerging New Era of Noncompetes and Trade Secrets."

I'm Randall Rubenking and you are listening to BakerHosts.

Our first episode "Yesterday, Today, Tomorrow" dives into the changing environment for noncompetes and trade secrets including statutory changes and how companies and employees will need to adapt going forward.

Our guests today are Joyce Ackerbaum Cox and John Siegal, co-leaders of BakerHostetler's Noncompete and Trade Secrets team.

Let's listen in.

Cox: Welcome to BakerHostetler's six part webinar series entitled The Emerging New Era for Noncompetes and Trade Secrets.

Today's topic is Noncompetes and Trade Secrets: Yesterday, Today, and Tomorrow. My name is Joyce Ackerbaum Cox. I'm a partner in the Orlando office of BakerHostetler and with me is my partner, John Siegal, who sits in New York. John is a partner in our New York office and together we co-chair Baker's national noncompete and trade secrets practice group.

So, let's go ahead and get started. John, I want to pose the first question to you. How do you view the world of noncompete and trade secret claims generally in recent years, and particularly in today's climate?

Siegal Yeah, Joyce, I think it truly is a new era. And why and how it's a new era will be a main, the main theme of this series. I think we're going to see two principle impacts. First, noncompete and trade secrets claims overall are going to be and are becoming harder to prosecute. And second, as a consequence, the tools businesses use to protect trade secrets are going to have to be used in a much more strategic and surgical way.

It really is a national trend. Noncompetes are increasingly viewed with greater skepticism. Start right at the top, the President of the United States is calling for curtailing the use of noncompetes. Twelve states and the District of Columbia have enacted limitations, or in some cases, prohibitions on the use of noncompetes in the past five years alone.

Academics and advocates in the pages of the New York Times and elsewhere have focused on perceived abuses of noncompetes and their economic effects, and then FTC rulemaking proceeding on the role of noncompetes and what should be done about them in the economy is about to begin. This trend, these trends, and it is a national trend, are having impacts. Look, judges and arbitrators are people, too. They're highly literate, highly public-attuned people. They see these things, they read these things, they see these developments and they're affected by them. The Federal Defend Trade Secrets Act, on the books now for five years, which has made trade secrets of federal intellectual property akin to patents, trademarks, and copyrights, is having a paradoxical effect.

It's opened the federal courts to trade secrets claims, and we look at the filings under the DTSA nationally every day, and it's very clear that a great deal of noncompete and trade secrets litigation of all sorts that was previously being brought in state courts have just moved across the street to the federal courts. That subjects these cases to the exacting standards of federal courts. On motions to dismiss, federal courts apply the Iqbal and Twombly standards, which are higher, more exacting standards than in most state courts. Under the federal

rules of civil procedure, live witnesses are required for preliminary injunction hearings. This means if you're seeking a trade secrets injunction within the first several weeks of a litigation, you're going to have to put on you proof, your live witnesses in court, which in most state courts, many state courts, you didn't have to do.

Federal judges, many of them are former prosecutors, tend to require or expect greater specificity of leading in proof, and most of all, they're used to controlling and protecting their own dockets. We've already seen cases in which federal courts dismissed trade secrets claims. Litigants went across the street to the state courts and got a preliminary injunction. Other developments, the Economic Espionage Act and Computer Fraud and Abuse Act, increasingly being used in trade secrets matters have raised the stakes for egregious trade secrets and misdeeds, and perhaps diminished courts' appetites for more garden variety cases.

Are there Covid impacts? I can't say. It's too soon to say, but when unemployment spikes and then really, a nationwide focus on employee mobility, it's hard to imagine there won't be impacts. And in some places, New York state, for example, our highest state court has cut back on available damages, prohibiting avoided cost or head start damages in the EJ Brooks versus Cambridge Security Seals decision. All of this is creating a changing and more complex landscape than before. And Joyce, I think the question for you is, how do you see these developments affecting enforcement and affecting business decision making day to day in the noncompete arena that you handle in employment matters?

Cox: Well, I think that you've touched on a lot. Let me briefly give my opinion, or what I've seen with respect to the Covid issue. Obviously, that is still playing out, but we've seen courts around the country, as with other types of litigation, handling everything Covid-related differently, right? Some courts are completely shut down. It's impossible to get a trial, nonetheless, you know, an emergency injunction or TRO hearing, so that's problematic if you've got to run into court as we often do in these sorts of cases. And any time right now, I think certainly for the next year or two, you've got to factor in delay on both sides of the equation and how you're going to deal with your noncompetes going forward.

But with respect to kind of some other trends that I'm seeing, John, in addition to what you've said about DTSA, some of the other federal acts, one of the things that I think that judges are doing is, as certain judges become, or have less tolerance, I will say, for these types of noncompetes which basically sit people out altogether. They're looking to use less restrictive types of measures, so they know that there are other types of restrictive covenants out there and they're looking to say well, I can do something of a lesser standard or that it has a smaller impact. So, maybe I'm just going to look at enforcing a non-solicitation provision. Or maybe I'm just going to look at enforcing a garden leave provision. A garden leave provision, for obviously for those who don't know, you basically pay the employee to sit on the sidelines during the period of the noncompete.

We're seeing more and more judges look to, I think, less restrictive measures other than an outright ban. The other thing, the other trend that we will see and that you're going to hear about later on in one of our future sessions, is the antitrust implication and overlay of all of this. So, we have seen a huge kind of push by the department of justice, by state attorneys general, and certainly by private plaintiffs. Many times in the class action kind of context, which focuses on businesses, not just in the civil range but for DOJ now in the criminal range where you've got to really careful as a business, whether it's employer to employee or business to business, having those contracts contain certain types of restrictions that you've had in place forever are not going to fly.

So, we're seeing from, as far as a trend, we're seeing a lot of re-looking at those agreements, revamping, and hopefully we are seeing some uptick in enforcement against businesses in these sorts of areas, so things that people definitely need to be prepared about.

Siegal: Joyce, do you see other technological or economic trends that are contributing factors in the difficulties of enforcing unfair competition and noncompete claims?

Cox: Yeah, I think that certainly in the trade secrets arena, right? And our folks in California and some places on the west coast and other areas where noncompetes have been disfavored or not allowed for a long period of time, they've been dealing probably more frequently with trade secrets types of claims and outright noncompete claims. But when it comes to trade secrets, I think what we're seeing is the theft is becoming more sophisticated, right? The theft nowadays, and I'm about to date myself, but it's not walking out the door with the rolodex that has all the customer list or the contacts or whatnot, but theft is most often electronic in nature.It's harder to detect. It's far more expensive to track down and to litigate. It requires a lot of outside experts, and it's not just experts that go in and look at one level. You've got to delve down into the different systems and you've got to look and see where this information is transferred. There's obviously a lot of nuances to that, and as we're seeing just in general everyday life outside of the legal arena, thieves are becoming more creative and that is certainly having an impact here, with respect to certain types of cyber theft and trade secrets.

The other thing that I will say that probably applies across the board with respect to noncompetes and trade secrets is this very global world we're living in.It used to be, I think, far more important to really craft a geographic restriction that was not going to be national or global because judges just didn't have a tolerance for that at all, and they wanted to see them. And they still do want to see them as narrowly tailored as possible, but a lot of times with the way that we have global competition around the world, certainly national competition. Certainly, things have become less important about geographic restrictions, and I think it has become less relevant than it otherwise was. And I will say one other thing that goes back to your point before, John, about Covid.

One of the impacts we will see is remote workers. So before, where people were working primarily for a company in one location, they're now working from their

homes or from their vacation homes in different states or sometimes different countries across the world. So, you've got to take into effect where's the employee sitting? Where did the violations occur? Where is the company located? Where is the former company located? Where is the new company located? All of those factors are going to, as they always do, play into litigation. But now I think you have this added kind of sense of what do we do with remote workers who are not in the area where we originally thought they were going to be when we first drafted or intended this contract to apply?

So, I think those are some of the trends that I'm seeing, and actually it sounds rather overall dismal, where it sounds like we're left with more restrictive state laws, perhaps some looming federal laws with respect to what President Biden and the FTC are going to do. Harder detection of claims generally, and an increased distaste by judges in the area. So John, with that kind of foundation, what's a business to do here?

Siegal: Yeah, I think that we all really have to pay very close attention to the public debate and the policy debate in this area, and take it seriously regardless of where it leads because it is a foreshadowing or a highlighting of the areas the judges and arbitrators, legislators, or regulators are concerned about, and that companies who are using noncompetes and restrictive covenants to try to protect their trade secrets and other vital interests really need to act in a more strategic, tailored, and concerted way to get out ahead of these trends.

To some degree, it just exponentially increases the importance of some of the advice we've given in the past, but it really does require a lot of companies to rethink their approach to managing their employment relations and trade secrets risks. What do we mean by that? I mean, to be blunt, it's time to leave some of the heavy-handed tactics in the past. Requiring noncompetes without notice to employees at the beginning of an employment tenure is not a good practice now. It's not permitted in some states. It's going to be a principal focus of the FTC proceeding, to be sure, and it's really on a going forward basis, not necessary for companies that get out ahead of these trends and deal with them proactively.

By the same token, requiring noncompetes across the work force without regard to trade secret or customer poaching risk is a practice that's going to make it both more difficult for companies to enforce their restrictive covenants and increase the odds that states attorneys general, the FTC, or others will start to focus on a company's practices. What does that mean? Well, one obvious example, now codified in 12 states plus the District of Columba, is that the routine across the board use of noncompetes for lower salary employees is a disfavored practice.

In some states it's an unlawful practice, but the threshold is for lower salary varies. It's 100, and we'll get into this more in the later sessions. It's $100,000 in the State of Washington. It's non-exempt employees under the federal FLSA in some other jurisdictions, but as a general matter, requiring noncompetes across the board for lower salary employees is a practice that should be phased out. Long noncompetes, and what's considered long, varies state by state to be sure, but long noncompetes without compensation during a post-employment

noncompete period for employees outside the C- suite are going to be harder to enforce.

No poach agreements where companies agree with competitors not to hire from each other, that is the subject of Justice Department investigations, as one of our partners will describe in great detail in a subsequent session. And no poach agreements especially outside of the context of settling litigation really are disfavored, and lawyers advising companies need to be very, very careful when clients come to them with those sorts of things.

So, best to avoid vague, broad noncompetes, and instead tailor them specifically to job responsibilities and to trade secret and competitive risks. Consider using the full array of tools. Garden leave, short periods of notice requirements at the end of the employment relationship, non-solicits, stock and deferred compensation forfeitures, all of these should be reviewed and considered, and used not necessarily cumulatively. There's a whole literature now in academia on the cumulative use, the overlapping use of restrictive covenants itself being an abuse of and disfavored practice.

But all of these tools used appropriately tailored to the job position, tailored to the trade secrets, and other competitive risks in specific employment situations, should increasingly be used rather than just relying on blunt noncompetes across the board. Now Joyce, are there steps that you think the companies should take to try to implement these things or consider them as they look ahead at this more complex landscape?

Cox: Yeah, I think the first thing that I think every business needs to do is pull out every one of their agreements that contains restrictive covenants. And again as I said, this is not just employer-employee covenants. This is also business to business. If you have these types of agreements or language or clauses within your agreements and you're never enforcing them, certainly you're going to hear some advice. And depending on the context, you may very well want to scrap them, because sometimes having them and doing nothing about them in the antitrust context is certainly more problematic. In the noncompete context, if you're never going to enforce them then there's no use to have them, and sometimes we've had folks try to use the argument against us of prior waiver.

Now, there's places where that's successful and places where it's not, but it is a subject of discussion. In addition to that, I think that you are going to want to be, as you said, John, tailoring the noncompetes in addition to position and knowledge base and whatnot, you really have to pay very close attention to the choice of well provision and the venue, because it is critical. As I said at the beginning, the state disparities are becoming more impactful in this area, and what John sees in New York or Massachusetts or some of the other states where he regularly is, is very different from what I see in Florida and Georgia and North Carolina and some of those states.

So, regardless of all this we're talking about, the state application of law and the venue are critical. And we used to say, particularly for multi-state employers and

national employers, they want something. Give me kind of a one size fits all. Well, there's never been a one size fits all in this arena, but we were generally safer drafting water and leaving it to the courts that have the ability to modify our blue pencil to kind of narrow it down. But I think we're going to see less of that. I think businesses are going to need to have different buckets of noncompetes for different groups, where they should anyway, for sales people or C-suite people or certain people that possess IT information, engineers, et cetera. But I think we're going to see more buckets, the different types of agreements based on position and also based upon state law.

I think that the other thing that we're going to need to talk about is the advanced and strategic planning that businesses are going to have to have. Are they really, as I said at the beginning, are they going to be enforcing these? We need to look at, they need to have some idea, so that when they call us on a Friday afternoon and say, employee Joe just walked out the door and he's taking my key customers, or he loaded a thumb drive and stole all of this equipment. What are we going to do? All this technology, I should say. What are we going to do? We have some things in place, particularly when it comes to trade secrets.

We do things such as trade secret audits, so for businesses, when obviously you're trying to enforce or defend against a trade secret claim, you have to know what are your assets, right? What are you trying to protect? And not just what are you trying to protect, but what are you doing to protect these things, right? What reasonable measures are you going to be able to articulate that you have in place that you rolled out to protect this technology? Because the courts are going to want to hear that, so I think a mix of all those sorts of things are going to be some of the things that we're going to be seeing and recommending to businesses to do. Is there anything else that you want to add to that, John?

Siegal: No, I think that what we're doing here today is really a preview of where this webinar series is going to go over the next six months.

Cox: So in closing, thank you so much for attending and we hope to see you soon, hopefully next month. Thank you, bye-bye.

Siegal: Bye.

Rubenking: Thank you, John and Joyce. If you have any questions for either John or Joyce, their contact information is in the show notes. Please join us next time for episode two: "Five Years After DTSA." Partners Mark Temple and Carey Busen will discuss the five year anniversary of the Defend Trade Secrets Act, which created a federal system of trade secrets law for the first time.

As always, thanks for listening to BakerHosts.

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