Trade Secrets/Non-Compete QUARTERLY UPDATE

2022-02

As with the first quarter of 2022, Trade Secret and Restrictive Covenant activity continues to be robust at both the state and federal level. State legislators continue to introduce, analyze and negotiate restrictive covenant bills, the Federal Trade Commission ("FTC") (and other Federal entities) appears to be entering into a new chapter with respect to its analysis/assault on restrictive covenant agreements and the resolution of trade secret and restrictive covenant cases continues to pick up as more courts return to normal activity. **The following is a summary of what we saw in the second quarter of 2022.**

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The Introduction of Restrictive Covenant Legislation Has Slowed But Several Significant Bills Remain Pending

In our last report we mentioned that 67 restrictive covenant bills were introduced in 21 different states in Q1 of 2022. Approximately 30 more bills, in another six states, were introduced after our Q1 update. The restrictive covenant bills in Oklahoma, Vermont, and West Virginia did not make it out of committee during the legislative session and are essentially dead. Illinois, Iowa, and Kentucky enacted new restrictive covenant legislation but the legislation only concerns nurses. Colorado, on the other hand, went "all in" on enacting a wide sweeping restrictive covenant statute that dramatically alters the restrictive covenant landscape. The Colorado statute, which goes into effect on August 10, 2022, essentially bans noncompetition agreements on any employee making less than $101,252.00 per year, bans nonsolicitation agreements on employees making less than $60,750.00 per year, and requires the employer to, prior to the start of employment, notify the potential employee "in clear and conspicuous language" that the employee will have to sign an agreement that "could restrict the employee's future employment options." (You can read more about the Colorado statute here).

Of the approximately 40 bills that remain active and pending, the focus of most restrictive covenant lawyers is on New York and New Jersey. New York currently has multiple versions of restrictive covenant legislation pending in its state house. It is

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unclear, at this time, whether any of the legislation will actually make it to the governor's desk. In New Jersey, proposed bill A3715 would require an employer to a) provide a potential employee with 30 *business* days' notice of the terms of a noncompetition agreement and b) inform the potential employee, in writing, that the employee has the right to consult with counsel before signing the noncompetition agreement. The New Jersey bill also limits the restrictive period of the noncompetition agreement to twelve months, allows employees to perform work for a customer so long as the employee does not "initiate or solicit" the customer, and mandates that New Jersey law cover any New Jersey citizen who is bound by a restrictive covenant. Perhaps most significant to employers, A3715 also requires that the employer notify the employee within ten days of termination as to whether the employer intends to enforce the noncompetition agreement and, if the employer decides to enforce, then the employer must pay the employee 100% of the compensation the employee would have received if he/she had been working for the employer during the noncompetition period. Like New York, it is difficult to determine whether this bill, or a modified version of this bill, will be enacted. We will continue to monitor the New York and New Jersey legislatures and provide periodic updates.

Washington, D.C. Surprises Everyone With its Restrictive Covenant Statute

Past readers know all about the restrictive covenant statute passed by the District of Columbia in January 2021 that, because of its idiosyncrasies and subsequent opposition, is scheduled to take effect on October 1, 2022. The D.C. original statute banned noncompetition agreements for any employee who works in the District or any prospective employee who the employer reasonably expects to work in the District. Similar to Colorado, the original statute also required employers to provide specific notice to their District employees, or those who will provide services in the District, that noncompetition provisions in the District are banned. (You can read about the District of Columbia statute here).

On July 12, 2022, the D.C. Council issued an additional (and presumed final) revision of the noncompetition statute. The revisions are substantial. For example, instead of a complete ban on noncompetition agreements, the revised statute allows noncompetition agreements for individuals earning over $150,000 or doctors making over $250,000. The revised statute also clarifies who is subject to the statute by declaring that the statute only covers employees who will spend at least half of their time physically in the District.

The revised statute did, however, maintain some of its original quirks. Casual babysitters and government employees are still excluded from the ban on noncompetition agreements. The irony of the Biden Administration examining ways to ban noncompetition agreements (see below) while the local governmental entity that houses the Biden Administration allowing Federal government employees to be subject to a noncompetition agreement should not go unnoticed.

The notice provision requiring employers to notify potential employees of the noncompetition agreement also remains part of the revised statute. Thus, as of October 1, 2022, employers will need to include the following for any of their employees working in the District:

> The District of Columbia Ban on Non-Compete Agreements Amendment Act of 2020 limits the use of non-compete agreements. It allows employers to request non-compete agreements from "highly compensated employees" under certain conditions. [Name of employer] has determined that you are a highly compensated employee. For more information about the Ban on Non-Compete Agreements Amendment Act of 2020, contact the District of Columbia Department of Employment Services (DOES).

Beware Private Equity, The FTC Continues Its March into the Restrictive Covenant Space and is focusing on M&A Activity

As we mentioned in several posts, the Federal Trade Commission ("FTC"), in accordance with President Biden's Executive Order, is scrutinizing restrictive covenants. Until recently, the FTC's "scrutinization" was largely limited to scholastic exercises such as workshops and research. This was likely due to the FTC being deadlocked with two Democratic commissioners and two Republican commissioners. On May 11, 2022, however, Alvaro Bedoya was confirmed to the FTC and the FTC now consists of three Democratic commissioners and two Republican commissioners. Shortly after Bedoya joined the FTC, Democratic Chairwoman Lina Khan followed through on plans she outlined in an interview she gave to the *Wall Street Journal* in September 2021. In the interview, Chairwoman Khan declared that her "concerns in private equity consolidations will be a top priority of the FTC," and she later hinted that the FTC would use enforcement actions to curtail the use of restrictive covenants in the private equity space.

On June 14, 2022, the FTC followed through on Khan's hint by using an enforcement action to declare that restrictive covenants contained in a merger agreement created "anti-competition issues" and required modification. Specifically, in a merger agreement between GPM Petroleum, LLC's ("GPM") and Corrigan Oil Company ("Corrigan"), GPM acquired 60 retail gasoline, diesel and convenience stores from Corrigan. In determining that the merger created "competition issues" in certain areas, the FTC required GPM to return five stores to Corrigan. The FTC also concluded that the restrictive covenants contained in the merger agreement were overbroad and, as such, a) narrowed the covenants to only cover the actual businesses acquired by GPM, b) reduced the duration of the restrictive covenants to three years, and c) reduced the scope of the restrictive covenants to three miles from each acquired location.

Given the above action and Khan's additional comments that the FTC has "issued subpoenas to a variety of businesses suspected of imposing unnecessary noncompete clauses on their workers," we can expect the FTC to continue scrutinizing restrictive covenants in the private equity space.

McDonald's Scores a Nice No Poach Win While Microsoft Says Goodbye to Restrictive Covenants

After years of lengthy and acrimonious litigation, McDonald's scored a no poach win when the United States District Court for the Northern District of Illinois ruled, on June 28, 2022, that McDonald's ex-workers could not succeed on an antitrust action alleging that the no poach provisions found in McDonald's franchise agreement stifled competition. In reaching its decision, the court found that McDonald's no poach provision did not, and could not, suppress the former employees' wages given the amount of other quick serve restaurants located around the McDonald's locations at issue. It will be interesting to see if other courts adopt the McDonald's court's analysis and ruling when analyzing no poach cases that involve a defendant who has several competitors located in the same market.

On the other side of the restrictive covenant/no poach scale, Microsoft announced in June that it will no longer have employees execute restrictive covenant agreements and will not enforce its existing noncompetition agreements with current US employees. Microsoft's stated position for eliminating noncompetition agreements is to "foster a workplace that attracts and inspires world class talent to unlock innovation aligned with our mission." Microsoft's decision to forego noncompetition clauses is interesting given that it was previously part of the Silicon Valley community investigated by the Department of Justice for entering into a secret no poach pact. So far, no other Silicon Valley company has followed Microsoft's lead.

Three Significant Trade Secret Decisions—A Massive Award for a Plaintiff, a Very Nice Award For a Defendant, and an Interesting Choice to be Made on Damages

In May, a Virginia jury awarded more than $2 billion in trade secret damages with respect to the theft of a software company's trade secrets. In *Appian v. Pegasystems*, No. 20-07216 (Fairfax County, Virginia), a former government contractor worked for Appian as a software developer. Pegasystems, an Appian competitor, hired the contractor and, in the process of doing so, had the contractor steal copies of Appian's confidential software. Pegasystems also used fake identities to gain access to Appian information and trial versions of Appian software. Pegasystems then used the stolen software and information to develop and sell its own competing software. Not surprisingly, the jury did not approve of Pegasystems actions and, as mentioned above, entered a $2 billion award. In addition, and although not specifically mentioned in the coverage of the award, the jury likely found that Pegasytems' theft of Appian's software was willful and malicious. Consequently, we would/will expect to see Appian ask the court to award Appian its attorneys' fees under the Virginia Trade Secrets Act.

On the other end of the trade secrets spectrum, a California state court, in the case of *Contemporary Service Corp. v. Landmark Event Staffing Servs, Inc.,* No. 30-2009-123939 (Superior Court of California, County of Orange), entered a $5.8 million attorney fee award on behalf of the defendant and against a trade secret plaintiff. In doing so, the court determined that plaintiff's claims of trade secret misappropriation were unfounded and that 13 years of litigation brought by the plaintiff were nothing more than a company illegally trying to hurt a competitor (as opposed to a company trying to protect its trade secrets). As a result, the plaintiff's trade secret case was brought in bad faith and the defendant was therefore entitled to recover its attorneys' fees.

Lastly, the Texas Supreme Court recently provided a trade secret plaintiff with a unique decision/dilemma, accept a $201 million dollar breach of contract win or go back to the court and try all of its claims, including a $740 million trade secret allegation. *HouseCanary Inc. v. Title Source Inc., No. 20-0673 (Texas S. Ct).* Real-estate startup HouseCanary obtained a $740 million award against a competitor, Amrock, for trade secret misappropriation. In addition to the $740 million, HouseCanary also obtained a $201 million award for a breach of contract claim. Since the damages for each claim overlapped, HouseCanary could elect to recover either the $740 million (trade secret) or the $201 million (breach of contract). Not surprisingly, HouseCanary elected to recover the $740 million. On appeal, however, the Texas Supreme Court upheld an Appellate Court's decision to reverse the trade secret misappropriation award because of faulty jury instructions. The Texas Supreme Court also found that the trade secret and breach of contract claims were inseparable, thereby leaving HouseCanary with two options. HouseCanary could either retry all of its claims or recover only the $201 million breach of contract award. HouseCanary is now currently deciding how to proceed.

Conclusion

Benesch's Trade Secret, Restrictive Covenants and Unfair Competition Group will continue to monitor important activities in, and changes to, the trade secret and restrictive covenant space. The Group will also provide periodic updates regarding new statutes, government actions, and case opinions that may impact the ability to enforce restrictive covenants or protect trade secrets. For the third quarter of 2022, the Group is offering CLE seminars on best practices for handling a trade secrets audit, drafting restrictive covenant agreements, and preparing for, or defending against, a restrictive covenant and/or trade secret case. Please contact any member of the Group if you would like to hear more about these offerings.

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