

Trade Secret Law Evolution Podcast
Greenberg Traurig, LLP
Episode 64

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Jordan Grotzinger: Welcome to the Trade Secret Law Evolution Podcast, where we give you comprehensive summaries and takeaways on the latest developments and trends in trade secret law. We want you to stay current and ahead of the curve when it comes to protecting [00:00:30] your company's most valuable assets. I'm your host, Jordan Grotzinger.

Welcome everybody to episode 64 of the podcast. This is a pretty quick turnaround for us, but that is because something big happened in our world this week, and that is the Federal Trade Commission on April 23rd voted three-two in favor of banning non-compete clauses, a big issue in the trade secret world. [00:01:00] We're doing this soon after our episode 63, and also late-ish for us. We usually do a morning recording and it's 5:05 in Los Angeles and it is 7:05 in Alabama, where my co-host Justin Victor sits. And we also welcome back our recurring co-host Greg Bombard in Boston where it is 8:06.

So the subjects of this podcast will be the new FTC decree and [00:01:30] specifically some background of how we got here, the three-two vote, the 120-day timeline for implementation and legal challenges facing the rule, a summary of the rule and exceptions, impact on current litigation, and considerations for employers and companies now.

Justin Victor: So let's talk about how we got here. And it seems like forever ago that I was on a podcast with you, Jordan, talking about President Biden's [00:02:00] executive order relating to non-competes. And that's because it was a long time ago. July 9th, 2021 to be exact.

And through President Biden's executive order on July 9th, 2021, he made clear that the government was going to take approaches necessary to overcome monopolization and unfair competition within the economy. And specifically, he directed the [00:02:30] Federal Trade Commission to use its rulemaking authority to restrict, reduce, or even potentially ban certain types of non-compete agreements.

And the order within its actual term said, "The chair of the FTC is encouraged to consider working with the rest of the commission to exercise the FTC statutory rulemaking authority under the FTC Act to curtail the unfair use of non-compete clauses and other clauses or agreements that may unfairly limit worker [00:03:00] mobility."

So from this executive order from President Biden in July 2021, we've got our way to a vote here in April 2024.

Gregory Bombard:

And last year, in early January of last year, the FTC came out with a proposed rule that was extraordinarily broad in scope. That proposed [00:03:30] rule would have effectively banned all non-compete agreements entered into in any employment context, either the employee/employer context or an independent contractor context. If that proposed rule had gone into effect, it would have invalidated all existing non-compete clauses.

When they published the rule in January of 2023, they [00:04:00] opened a comment period for the public to comment on the proposed rule. They got thousands of comments during that period, and because of the volume of comments and the interest from the public, the FTC extended the comment period, and then for a significant period of time was apparently working on the rule that came out this week.

This week on April 23rd, [00:04:30] the FTC released the rule in the same meeting and voted to release the rule to the public. So we got our first peek at it. And then shortly thereafter, voted three to two to adopt the rule as a final rule. And at a high level, the rule bans the use of non-compete agreements across the country going forward in any employment context, both employees and independent contractors. [00:05:00] And we'll talk about the specifics on how broad the rule is and what the exceptions are as we move along.

Obviously it's a three to two vote. It's worth noting that there were two dissenting commissioners on the FTC who questioned whether the FTC had authority to promulgate a rule like this. The business community has also come out with their own challenges. [00:05:30] The Wall Street Journal editorial page came out with an editorial questioning the validity of the rule, and the US Chamber of Commerce has already filed suit challenging the validity of the rule in federal court.

Jordan Grotzinger:

Yeah, the Journal's comments on April 24th the next day, were pretty sharp. It said "Lina Kahn's latest rule instantly invalidates 30 million contracts without congressional authority." "Is there anything [00:06:00] that Federal Trade Commission Chair Lina Kahn doesn't think she can do? Apparently not." So we know where the Wall Street Journal stands. So what is the actual impact today in April 2024?

There is no change to non-compete law for now based on this decree. The rule will go into effect 120 days following its publication in the Federal Register. Further, the rule is already subject to numerous [00:06:30] legal challenges. For example, the US Chamber of Commerce has already filed a lawsuit against the FTC, challenging the authority of the rule and seeking a declaratory judgment, invalidating it, and an injunction against its enforcement.

In a separate matter, a private employer filed a lawsuit in the US District Court for the Northern District of Texas, seeking to vacate and set aside the final rule for reasons including, one, that the FTC does not have [00:07:00] the authority to issue the rule, and two, that the rule is unconstitutional. And GT is going to be monitoring the litigation and will provide updates on developments regarding this rule.

Justin Victor:

And Jordan, that's so important, because the question that I'm getting over and over from everyone is what's the impact today? And you perfectly covered that. For now there's no change. You have to pay attention to how things develop both through the court system [00:07:30] and when this potentially could be implemented and in what form. But setting the table that there is no change today, but there's uncertainty going forward, let's discuss what was actually in this final rule that passed.

So first of all, the rule purports to supersede all state law. So if you're in a state like Georgia or Florida, which has a restrictive covenant statute that specifically says that under certain circumstances restrictive covenants should be enforced, [00:08:00] the FTC's rule essentially says we don't care what the state says or state's jurisprudence, everybody in the country has to follow the FTC's rule, and we're going to be invalidating non-competes through the FTC's rule. So I think this is really important. It is the FTC's opinion that based on the rule, they're taking away the decision-making from the states. And whether that's by statute or jurisprudence, it is the FTC's rule that would be governing in these specific states.

[00:08:30] The second important thing is the rule is incredibly broad. It serves to ban all employment related non-competes. This would include non-competes with senior executives, with CEOs, with independent contractors, regardless of how much they're making in salary, and regardless of how much access they have to confidential or proprietary information.

There are some exceptions to the rule which we'll discuss later, involving [00:09:00] the sale of a business, and certain employers that aren't subject to the FTC's guidance. But the rule as drafted, if it passes, on a go-forward basis, it will not be allowable to use a non-compete essentially with any employees for employers that are covered by the FTC's jurisprudence.

The rule defines a non-compete clause very broadly as well, and would include any provision that penalizes [00:09:30] or prevents a worker from seeking or accepting work in the United States with a different person where such work

would begin after the conclusion of employment that includes the term or condition, or operating a business in the United States after the conclusion of employment that includes the term or condition. So essentially, non-compete is going to be very, very, very broadly defined, not just in terms of what it covers, but also the types of [00:10:00] arrangements after employment that could be considered competitive.

Generally, most non-disclosure agreements and non-solicit agreements do not appear on their face to be covered by the rule. But what's really important, if you read the comments from the FTC, if certain provisions that are non-solicit provisions or are non-disclosure provisions function to prevent a worker or employee from seeking or accepting work or starting a new business after employment ends, such [00:10:30] provisions could be barred by the rule.

So practically what that means is if this rule were to go into effect, the FTC is saying we're not disallowing NDAs, confidentiality agreements and non-solicit agreements, but if you cross the line, if you make the confidentiality terms too aggressive, were to actually prevent somebody from competing, or a non-solicit so aggressive that it practically would prevent somebody from being employed [00:11:00] in a competitive field, then we will take that language, function to prevent, and consider such a term a non-compete.

On day one, if this rule were to pass, on a go-forward basis, non-competes with employees would be unallowable. However, to the extent you're a company and you had non-competes in place with your workforce before the rule became effective, those non-competes, [00:11:30] with very limited exceptions, would also be invalidated. So I want to say that again. If you're an employer and this rule comes into play and it actually passes and it survives legal challenge and it becomes finalized, not only on a go-forward basis can you not use non-competes, but the non-competes you have in place with very limited exceptions are going to be invalidated. And the limited exception that exists is for senior executives. And the FTC [00:12:00] defined senior executive as an individual making over \$151,000 a year, and who is in a policymaking position.

Further, the rule if implemented would require employers to give notice to all existing employees with unenforceable non-competes, informing them that the restrictions that they have in place are no longer enforceable.

So as a takeaway, if this rule passes, what's the practical effect? The practical effect is employers [00:12:30] who are subject to the FTC's jurisdiction are not going to have non-competes as a tool that they can use with employees on a go-forward basis. And if employers fail to adhere to the FTC's guidelines, they could be subject to fines and penalties and injunctive relief by the FTC, but also it's going to be impractical to try and enforce non-competes in court because if this rule [00:13:00] is accepted by the courts, you won't be able to seek injunctive relief and enforce the restrictive covenants that you have in place with your employees.

Gregory Bombard: So needless to say, the scope of the rule is extraordinarily broad as Justin said, but there are a few important exceptions to the rule. One is it only applies in working relationships, labor relationships. So in an employer and an employee relationship, [00:13:30] if the rule survives, then no non-competes would be permitted in that relationship. An independent contractor working as an independent contractor for an employer, no non-competes agreements would be permitted if the rule survives. But in a traditional business to business contract, those types of non-compete or exclusivity clauses, those are still going to be [00:14:00] governed by traditional antitrust law. Obviously there are existing restrictions on agreements between competitors not to compete, but those are not affected by the FTC's new non-compete ban.

Another very important and significant exception to the FTC's rule is the sale of a business exception. The rule doesn't apply to non- [00:14:30] compete agreements that are entered into in the context of the sale of a business. But even that limitation, even that exception is limited. For the sale of business exception to apply, the non-compete has to be imposed on "a substantial owner of, or substantial member, or substantial partner in the business entity." So [00:15:00] only substantial owners of a business that's being sold can be subject to a sale of a business non-compete. But that exception does apply. That's a very important exception in the context of M&A.

The third significant exception is that the FTC has limited jurisdiction under its Enabling Act. And so [00:15:30] the rule will only apply to companies that fall within the FTC's jurisdiction. So that's not all employers. It's many employers, but not all.

As an example, nonprofit companies and some financial institutions are not subject to the FTC's jurisdiction. One other exception to the rule is with respect to existing claims or existing litigation. The rule does [00:16:00] not apply to claims for a breach of a non-compete agreement that accrue before the effective date. And what that means is that if there is ongoing litigation as of the effective date, or the ability to pursue litigation for breach of a non-compete agreement on the effective date, it won't apply retroactively to those agreements. So this will be a somewhat narrow set of agreements, but it's [00:16:30] relatively significant for litigation that's ongoing right now or contemplated right now. The rule should not affect the outcome of that litigation.

Jordan Grotzinger: That was a merciful provision, I would say. I imagine the mess if the opposite were true. So what to do now?

Companies should continue to monitor the pending legal challenges to the rule. They should consider revising agreements [00:17:00] with their employees to place more emphasis on restrictions that do not fall within the non-compete category. And maybe most importantly, focus on and bolster measures to protect trade secrets.

I live in California where non-competes are already illegal, and life goes on. The key here is to protect trade secrets where real competitive advantage lies.

[00:17:30] I mean, think about it, the harm largely comes from the information or know-how taken with the departing employee. And so it's so important that trade secrets not be taken, because they are often a company's most valuable assets. And so despite the ban on non-competes here in California, you [00:18:00] are not allowed to misappropriate trade secrets, period.

So make sure they are protected. That's probably the most important step at this point. And that, by the way, making sure they're protected, is one of the elements of a trade secret, specifically taking reasonable measures to protect its secrecy. And as we've discussed many times here, those protections generally fall into three buckets. One, contracts and policies like employment [00:18:30] contracts and corporate policies, employee handbooks, et cetera. Two, technology, which is hugely important now. Things like passwords, VPNs, firewalls, et cetera. And three, physical, meaning lock your doors and mark your confidential stuff accordingly.

The test for measures to maintain secrecy and whether that element of a trade secret [00:19:00] is met, is whether the measures are reasonable. It's not perfect, has to be reasonable. And in our experience, and I think based on common sense, very simply, the more, the better.

So that's a quick update of the FTC rule. We hope it was helpful. I think I speak for my partners when I say there's no better way to spend a Friday night. And we look forward [00:19:30] to the next episode. Thanks everybody.

Okay, that's a wrap. Thanks for joining us on this episode of the Trade Secret Law Evolution Podcast. As the law evolves, so will this podcast, so we value your feedback. Let us know how we can be more helpful to you. Send us your questions and comments. You can reach me by email at grotzingerj@gtlaw.com, or on LinkedIn. And if you like what you hear, please spread the word and feel free to review us. Also, please subscribe. We're on Apple [00:20:00] Podcasts, Stitcher, Spotify, and other platforms. Thanks everybody. Until next time.