Trade Secrets/Non-Compete QUARTERLY UPDATE

2022–Q3

Compared to Q1 and Q2 of 2022, Q3 was relatively slow with respect to trade secret legislation and significant restrictive covenant awards and/or case law. Still, and as described below, two new statutes require a company's attention, the Federal government is remaining criminally, civilly and administratively active, and even law firms are not immune to trade secret allegations.

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Restrictive covenant legislation goes into effect in Colorado and Washington, D.C., and two significant bills remain pending in New Jersey and New York.

As discussed in previous articles, the two most significant restrictive covenant laws passed in 2022 involve Colorado and the District of Columbia. On August 10, 2022, Colorado's new restrictive covenant statute went into effect. The statute bans noncompetition agreements on any employee making less than $100,252 per year and bans nonsolicitation agreements on employees making less than $60,750 per year. The statute also requires employers to notify potential employees, prior to the start of employment and "in clear and conspicuous language," that the individual will have to sign an agreement that "could restrict the employee's future employment options." In a twist from notice requirements enacted by other states over the last couple of years, the Colorado statute also requires that the potential employee sign and return the notice to the employer, thereby acknowledging that the potential employee has, in fact, been notified about the restrictive covenants. (You can read more about the Colorado statute here).

The Washington, D.C. restrictive covenant statute went into effect on October 1, 2022. The statute bans noncompetition agreements for individuals earning over $150,000 or doctors making over $250,000. Similar to Colorado, the D.C. statute also requires employers to notify individuals subject to restrictive covenant agreements about the ban. (The notice provision regarding the D.C. ban can be found by clicking here).

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No additional significant restrictive covenant legislation was introduced in the third quarter of 2022. This is likely due to federal and state mid-term elections occurring in November and, as such, legislators being more concerned about their election prospects than restrictive covenant legislation. Of legislation that is still actively pending, the bills in New York and New Jersey are by far the most significant because both bills would place significant restrictions on the enforcement of restrictive covenants. New Jersey bill A3715 would require an employer to provide a potential employee with notice of the terms of a noncompetition agreement, limit the restrictive period of the noncompetition agreements to 12 months, allow employees to perform work for a customer so long as the employee does not "initiate or solicit" the customer, and require the employer to pay the employee 100% of his/her compensation during the noncompetition period. New York Senate Bill S6425 would ban all noncompetition agreements in New York and allow employees to recover liquidated damages "up to $10,000" against an employer who had the employee sign a noncompetition agreement. We will continue to monitor both bills and provide periodic updates.

At the federal level, Representative Mike Garcia of California introduced a bill in the House of Representatives on September 1, 2022 that would effectively ban noncompetition agreements for nonexempt (i.e., low to mid wage) employees. The legislation, known as the "Restoring Worker's Rights Act", is similar to legislation introduced in previous years by Senator Marco Rubio of Florida. The legislation is in line with legislation enacted over the last two years in 10 states (Colorado, Illinois, Maine, Maryland, Massachusetts, Nevada, New Hampshire, Oregon, Rhode Island, and Virginia) and the District of Columbia that establish compensation thresholds with respect to the enforceability of restrictive covenants. At this time, the bill is unlikely to make it out of the House of Representatives and, just like its predecessors, unlikely to be enacted into law.

The FTC announces that it will focus on the use of restrictive covenants in "mergers and business practices"

The Federal Trade Commission ("FTC"), following through on President Biden's instructions to evaluate and possibly issue rules and instructions regarding the elimination and/or governance of noncompetition provisions, published its "Strategic Plan for Fiscal Years 2022-2026" on August 26, 2022. One of the Plan's objectives is to investigate "anticompetitive activity with respect to mergers and business practices." The investigation, according to the FTC, will include an evaluation of the "increasing use of provisions that decrease worker mobility through the use of noncompetition provisions." The investigation will also include studies that research the impact of restrictive covenant agreements on worker wages and benefits.

Davita is not done with its no poach woes, Papa Johns settles, and the DOJ gets a win

If DaVita and its former CEO, Kent Thiry, thought that their no poach issues were behind them after defeating the Department of Justice's ("DOJ") criminal prosecution in Colorado, (for a discussion on the criminal case please click here), the United States District Court for the Northern District of Illinois squashed those thoughts when it allowed a no poach class action complaint to continue. In the class action, the plaintiffs alleged that DaVita and Thiry executed illegal no poach agreements with competitors Surgical Care Associates and Tenet Healthcare Corporation that resulted in damages to the plaintiffs. The court determined that the plaintiffs pled sufficient facts to demonstrate an injury arising from the companies "no poach pacts" and, consequently, discovery will now proceed on the plaintiffs' antitrust claims.

No poach class action plaintiffs also received a win in July when Papa Johns agreed to pay $5 million to a class of former employees who claimed the no poach provisions in Papa Johns' franchise agreements suppressed their wages and business opportunities. The settlement is significant because it goes beyond

the deal Papa Johns made with the Washington Attorney General's office last year to stop enforcing the no poach provisions in its franchise agreements.

On the criminal side, the DOJ scored its first win with respect to the criminal no poach cases it has brought against companies and senior executives. In the first case to go to trial, United States v. Jindal, the DOJ brought five counts under the Sherman Act against a therapist staffing company and the jury rejected all five. In the next case to go to trial, the DaVita and Thiry case mentioned above, the DOJ lost again. On September 2, however, the DOJ informed the public that Ohio based company VDA OC, LLC and its former regional manager, Ryan Hee, intended to plead guilty to conspiring with competitors to suppress wages and opportunities for nurses staffed by their companies in Clark County, Nevada. The terms of the plea were not announced, but under sentencing and statutory guidelines, VDA could be subject to a $100 million fine or twice the monetary impact it gained by suppressing wages and prohibiting the transfer/recruitment of nurses by competitors.

The DOJ continues to achieve success in Trade Secret Prosecutions, especially with trade secret theft involving China

The DOJ was active in several criminal trade secret cases in the third quarter of 2022. For example, a Southern Illinois University math professor received a year of probation after being convicted of concealing a Chinese bank account from federal officials and stealing University trade secrets on behalf of the Chinese government. A former Broadcom engineer pled guilty and was sentenced to eight months in prison for stealing trade secrets on behalf of a Chinese competitor. The trade secrets concerned networking chips that are used in high volume data centers. Lastly, a former Texas A&M University professor pled guilty to making false statements to NASA about his affiliation with a Chinese university. The professor's false statements where part of the Chinese government's "talent plan" to recruit individuals and incentivize them to steal information for the benefit of the Chinese government.

In contrast, a Kansas federal judge in September tossed three of the four convictions against a University of Kansas professor convicted of concealing his ties to a Chinese university. The court's actions were not surprising since, shortly after the professor was convicted by a jury in April, the court expressed concerns/skepticism about the government's evidence and prosecution of the professor. In its decision to overturn parts of the jury verdict, the court followed through on its skepticism about the conviction by stating that three of the wire fraud counts lacked enough evidence for a guilty verdict. The judge did, however, keep the guilty verdict with respect to the professor being deceptive in not disclosing his work for a Chinese university.

In a trade secret criminal case not involving Chinese ties, the DOJ indicted two former Deloitte executives who allegedly took trade secrets regarding Deloitte's unemployment insurance processing systems and used the trade secrets to build a competing product. When confronted by the DOJ about Deloitte's allegations, the two former executives allegedly lied to federal investigators about their activities and the government responded with trade secret theft indictments. The case was brought by the US Attorney's Office for the Southern District of West Virginia but, interestingly, its impact is being felt in Kentucky, Ohio and Texas. Specifically, Sagitec, the two individuals' new employer, was involved in the replacement/upgrade of insurance processing systems in Kentucky, Ohio and Texas before the indictment. Since the indictment, these projects have either stalled while the states allow the criminal case to play out or, in the case of Kentucky, started over with soliciting new bids from technology vendors.

Trade Secret litigation is rare between law firms, but it does happen

Trade secret litigation between law firms is rare given the Rules of Professional Conduct's prohibition on restrictions that prevent clients from working with the attorneys of their choosing. Yet, Littler Mendelson filed suit against Polsinelli in the United States District Court for the Northern District of Georgia alleging that its former partner stole proprietary information regarding products prepared by Littler for the home care business. Littler alleges that Angelo Spinola, a former Littler shareholder in charge of Littler's "home care tool kit", and other former staffers transferred Littler trade secrets about the tool kit before they went to Polsinelli in early 2021. Spinola and the former staffers then used the tool kit to develop a Polsinelli product that competes with Littler's tool kit.

Littler initially sought a temporary restraining order against Polsinelli that enjoined Polsinelli from using its alleged trade secrets. Littler, however, dropped its TRO request on the second day of a two-day hearing when the judge overseeing the case commented that Littler had not sufficiently identified which of the 30,000+ documents at issue were Littler trade secrets. Still, Polsinelli and Spinola did not get a free pass from the court. In its decision, the court noted that Spinola's "suspicious late-night activity … on the eve of his departure from Littler," as well as the "speed with which Polsinelli was able to launch a competing tool kit," suggested a plan by Spinola to convert Littler's tool kit to a Polsinelli tool kit. The judge's ruling and actions in this case are a reminder to companies that it is not enough to simply allege that information is stolen in order to support a trade secret claim and achieve injunctive relief. Rather, a company must be prepared to demonstrate why the information is a trade secret and worthy of trade secret protection before it goes into court seeking injunctive relief.

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 fourth 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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