Trade Secrets/Non-Compete QUARTERLY UPDATE

2024-Q1

Welcome to our Q1 Trade Secrets and Restrictive Covenant Report. As you will note from reading the report, the first quarter of 2024 continues the trend of state legislatures exploring the possibility of new restrictive covenant laws, a couple of significant trials (with wins for the defendants for a change) and a ruling by the Delaware courts that could give companies a new avenue for enforcing restrictive covenants. Yet, the biggest news comes from (not surprisingly) the FTC who announced yesterday that **the vote on its noncompete ban will take place this Tuesday (April 23rd)**.

I. The state of Washington becomes the first state to amend its restrictive covenant laws, Maine's Governor vetoes a noncompete ban, the FDIC gets involved and everyone braces for the FTC fireworks.

The trend of state legislatures drafting restrictive covenant bills continues to rocket upwards as 72 restrictive covenant bills were introduced in 32 different states in the first quarter of 2024. Although most of these bills will never make it to the governor's desk for signature, and some have already failed (most notably, a Maine bill to ban employee noncompetes was vetoed by the Governor in March), one bill was enacted. In the state of Washington, a new statute goes into effect on June 6th that expands Washington's noncompete statute to cover customer nonsolicitation restrictions and mandates that a nonsolicitation restriction can only cover "**current**" customers. Put differently, any nonsolicitation restriction that covers "prior" or "prospective" customers will no longer be enforceable in Washington. In addition, an employer has to provide notice of the terms of the noncompete before "initial oral or written" acceptance of an offer in order for the noncompete to be valid. Lastly, the new Washington statute:

- requires all noncompete agreements involving Washington citizens be litigated in Washington and governed by Washington law;
- creates a private cause of action that allows both the employee and nonparties (i.e. new employers) to sue the prior employer for any attempt or threatened attempt to enforce a restrictive covenant that does not comply with the statute;
- mandates that restrictive covenants in the sale of a business setting can only apply to individuals who own at least 1% of the business.

These new restrictions, combined with the restrictions created by the original Washington noncompete statute (compensation thresholds of $100,000 for employees and $250,000 for independent contractors, employer must pay employee's base salary during the restrictive period if employee is terminated by employer, and noncompetes longer than 18 months are unenforceable), should trigger companies with Washington employees to review their restrictive covenant agreements before June 6th.

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Despite all of the activity by state legislatures, the focus of restrictive covenant lawyers remains the FTC. As we reported in several past quarterly and year end reports, the FTC's proposed ban to eliminate employee noncompete agreements and limit the use of noncompetes in the sale of business settings has yet to be enacted. **However, the FTC announced yesterday that it will be voting on the proposed ban this Tuesday.** We will be watching the meeting and will issue a client alert as soon as it ends. We will also watch the subsequent fireworks as several lawsuits will be filed throughout the country seeking to block enactment of the ban.

Although the FTC's proposed rule garners the most attention (and rightfully so), several other Federal agencies have begun to weigh in on the enforceability of noncompetes. We have already reported on the DOJ's, DOL's and NLRB's forays into the noncompete discussion. In addition, the FDIC is now considering an amendment to its "Statement of Policy on Bank Merger Transactions" that prohibits selling institutions from entering into noncompete agreements with any employee of the divested entity or from enforcing any existing noncompete agreements with any of those entities." Finally, some states have started to mimic parts (or all) of the FTC's proposed rule. For example, the Illinois legislature introduced a bill that would ban all noncompetition and nonsolicitation covenants that cover any Illinois citizen "regardless of whether the contract was signed, and the employment was maintained outside of" Illinois. The statute would also require employers to notify employees in writing that the noncompetition and nonsolicitation covenants are void and unenforceable.

II. Trade Secret Defendants collect a couple of wins, a BigLaw Recruiter gets hit, and Companies should continue to take note of what is happening in Delaware.

Previous Quarterly reports largely focused on large trade secret and/or noncompete verdicts in addition to substantive rulings that refined, modified or limited trade secret and/or restrictive covenant law. For Q1, however, we start with wins for trade secret defendants. Urban Outfitters defeated a trade secret claim brought by an online fashion rental company, Le Tote Inc., who accused Urban Outfitters of trade secret theft. After deliberating for an hour, the jury concluded that although the information Le Tote alleged Urban Outfitters took was a trade secret, there was no evidence of "misappropriation" because the information was disclosed through, among other agreements, an NDA between Le Tote and Urban Outfitters when the two companies were exploring a potential deal. The jury's decision is a reminder that companies need to understand/pay attention to the terms of an NDA before sharing information with a potential collaborator, negotiate NDA terms at the start of the relationship that protect trade secrets, and confirm that trade secrets are being protected at the beginning, middle **and end** of the relationship.

In the Southern District of New York, the Court reduced a $201 million trade secrets award to $8.5 million. In doing so, the Court determined that the plaintiff's theory of damages based on developmental costs the defendant avoided by stealing the trade secrets at issue was "legally erroneous" because the damages did not "restore the plaintiff to the position it would have been in but for the [theft]." The Court further determined that the theft did not diminish the value of the trade secrets or impair the plaintiff's ability to use the trade secrets. Thus, the only damage incurred by the plaintiff was its actual loss of $8.5 million in lost profits. The Court did, however, award plaintiff $14.5 million in attorneys' fees. Also, an Ohio Appellate Court affirmed a trial court's refusal to blue pencil an overly broad noncompete, even though the former employee was competing with the company, because it barred the employee from working outside of the territory he covered for the company.

For plaintiff trade secret/restrictive covenant wins, the United States Court of Appeals for the 5th Circuit upheld a $6 million trial award against a BigLaw recruiter who stole his prior employer's trade secrets and violated a noncompete agreement by using the trade secrets to solicit his prior employer's customers to leave his prior firm and join him at a new recruiting firm. In affirming the award, the Appellate court affirmed the lower court's determination that customer names, practice worth, language skills, law school records and reasons for changing jobs were trade secrets.

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The more significant "plaintiff win," however, came from the Delaware Supreme Court. In *Cantor Fitzgerald v. Ainslie*, the Court determined that a forfeiture clause relating to a restrictive covenant violation should be analyzed "under a more deferential, contract law standard that respects the mutual intent of willing, competent parties" instead of the "public policy against noncompete agreements" and the requirement that the restrictive covenant meet the Delaware court's definition of "reasonableness." Consequently, a company's determination that a former employee violated a restrictive covenant clause and, in doing so, forfeited certain compensation (bonus, stock options, grants, deferred compensation, etc.) will be upheld absent "unconscionability, bad faith, or other extraordinary circumstances." A request for injunctive relief will still be subject to the normal review of "reasonableness." Given the Court's ruling, a company could succeed on clawing back or declaring a forfeit of the departing employee's compensation even if the company is unsuccessful in obtaining injunctive relief because the restrictive covenant failed to meet Delaware's "reasonableness" standard.

It will be interesting to see if other states follow Delaware's lead as most states do not have clearly distinguished standards between evaluating a) forfeiture provisions tied to restrictive covenants and b) the enforceability of restrictive covenants in a request for injunctive relief. Indeed, one case out of the Seventh Circuit, *LKQ Corporation v. Robert Rutledge*, is questioning whether the *Cantor Fitzgerald* holding applies "outside the limited partnership context and if it does not apply in all other circumstances, what factors inform its application?" The Seventh Circuit has posed this question to the Delaware Supreme Court, and it will be interesting to see if the Delaware Supreme Court answers the question.

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. The Group is also offering a flat fee review of restrictive covenant agreements to assess whether the agreements comply with the recent changes to restrictive covenant law. If you would like to hear more about these offerings, please contact **SCOTT HUMPHREY** at 312.624.6420 or shumphrey@beneschlaw.com.