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EMPLOYMENT LAW COMMENTARY

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PROTECTING INVESTMENTS IN PEOPLE AND IP WHILE AVOIDING CRIMINAL SANCTIONS

By Roxann E. Henry, Lisa Phelan, and Eric Akira Tate[1]

"Employees leaving an organization might be replaced physically, however, their skill-sets and knowledge cannot be exactly replaced by the person replacing them… the skill of employees, account for 85% of a company's assets."[2]

"[W]e are going to aggressively protect our intellectual property. Our single greatest asset is the innovation and the ingenuity and creativity of the American people. It is essential to our prosperity and it will only become more so in this century."[3]

"Half of employees who left or lost their jobs in the last 12 months kept confidential corporate data, according to a global survey… 40% plan to use it in their new jobs."[4]

A company's intellectual property and employees are indisputably among its most important assets. Ironically, there is an inner tension between them because they also pose grave threats to each other. This article will examine recent initiatives by

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the U.S. Department of Justice Antitrust Division to prosecute (including potentially criminally) anti-poaching pacts between companies that improperly limit employee mobility, and also what employers can still lawfully do within the bounds of the regulations of the Antitrust Division and other laws to protect their people investments.

ANTITRUST ENFORCEMENT

You've invested a lot in your employee base. At considerable cost, you've found the right people, developed and trained them, and disclosed to them some or all of your treasured IP. Now you want to keep some other company from reaping the benefits of your investment. And you know which other companies would be most interested in your employees and would like to protect their investments rather than engage in a bidding war over employees. STOP THERE! That last thought can lead to disastrous consequences. Even if you have no products that compete with another company, that other company can be your competitor for employees. And competition triggers the antitrust laws.

A change in the policy against no-poach (*i.e.*, employee non-solicitation) agreements of the Antitrust Division of the Department of Justice surprised some executives and HR staff, who did not have antitrust on their radar. The Division followed its civil enforcement actions against nine prominent high-tech Silicon Valley companies[5] by creating the Antitrust Guidance for Human Resource Professionals (Guidance), along with the Federal Trade Commission, in October 2016.[6]

The Antitrust Division's continued focus is expanding further the depth and scope of the antitrust risk related to agreements about employees. Agreements not to compete can subject a company to criminal fines of up to $100 million or double the loss or gain from the agreement. Individuals involved in such agreements face a statutory maximum of 10 years in jail per agreement. The Guidance explicitly notes the availability of such criminal sanctions. The antitrust laws also provide for victims to sue for treble damage and recover their attorneys' fees. Shareholder suits have challenged boards and executives that do not implement adequate compliance programs or misstate earnings reports due to antitrust violations.

The speed of follow-on consequences from government enforcement is swift. On April 3, 2018, the Antitrust Division announced a civil settlement regarding a no-poach agreement that had come to light in the context of a merger review.[7] Only 13 days later the first of a number of follow-on antitrust treble damage class actions, was filed on behalf of the relevant employees. To give some sense of the expectation of the lawyers bringing these claims, $604 million in civil settlements from the earlier follow-on civil cases involving the Silicon Valley companies garnered two of the biggest payouts in class counsel attorneys' fees and costs in federal courts in California in the last eight years, according to Bloomberg Law's Class Action Settlement Tracker.[8] Those fees present a significant incentive to bring class civil cases.

Recognizing that until recently many companies had not appreciated the consequences of no poach agreements, the Antitrust Division explained that it had chosen to proceed civilly, rather than criminally, in this recent matter because the conduct had ended prior to the October 2016 Guidance release. For conduct that continues past that time, the Antitrust Division may not be as generous and will target for criminal sanctions.

Most importantly, in announcing this settlement, the Antitrust Division reiterated, as its officials have done on numerous occasions since last fall, that "it intends to bring criminal, felony charges against culpable companies and individuals" and that the Antitrust Division has instituted "a broader investigation into naked agreements not to compete for employees."[9]

EMPLOYEE MOBILITY AND IP PROTECTION

The Antitrust Division's current focus on anti-poaching agreements is consistent with a growing movement across the country to limit the use of non-competition agreements and restrictions on employee mobility. On April 26, 2018, Congress announced the introduction of a package of bills in both the House and Senate, that included the Workforce Mobility Act of 2018, H.R.5631 (WMA)[10] and the End Employer Collusion Act, S.B. 2480 (EECA) and a couple of others.[11]

The WMA would make it unlawful for an employer to enter into a covenant not to compete with an employee and create a private right of action allowing a prevailing employee to collect damages, including punitive damages, and reasonable attorneys' fees and costs. The WMA contains a carve out that expressly permits agreements between an employer and employee barring the employee from disclosing trade secrets.

The EECA would be similar to the WMA, except the EECA would bar any agreement between two employers that prohibits or restricts one employer from soliciting or hiring another employer's employees or former employees. The EECA would offer the same remedies as the WMA but, in its current version, does not include any exceptions whatsoever.

In several states, including New Hampshire, New Jersey, Pennsylvania, Vermont, and Washington, similar bills have been proposed and are being considered as well. This is not the first time bills of this nature have been proposed in

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Congress or state legislatures, and the likelihood of any of these bills passing into law is, at best, uncertain. But whether or not they ultimately pass into law, they serve as further examples of a greater interest in lessening potential restrictions on employee mobility in the United States.

Massachusetts, which just passed sweeping changes to its laws on non-competition agreements, is a prime example. On July 31, the Massachusetts Legislature passed legislation[12] for the first time codifying Massachusetts' law on non-competition agreements. If signed by the Governor, which is expected, the new law will be effective and apply to non-competition agreements entered into on or after October 1, 2018. Going forward, therefore, non-compete agreements in Massachusetts will only be valid for 12 months after termination of employment subject to certain exceptions described in the bill. Employers will need to pay 50% of the employee's annualized base salary during the non-compete period. An employer will need to present the non-compete agreement to a new employee within ten (10) days of the employee starting work and specifically advise the employee of his or her right to consult a lawyer before signing. And non-competes will not be permissible for non-exempt employees or any employees who are terminated without cause or laid off, although such employees can still enter into non-competes as part of separation agreements. It remains to be seen what impact the new law has on business and innovation in Massachusetts. But the new Massachusetts legislation only confirms the business and societal interest and scrutiny of non-competition agreements.

Courts also appear to be applying greater scrutiny to non-competition agreements. For example, in Delaware, a state long known for having some of the most supportive laws favoring corporations in the nation, recent decisions by state courts may suggest a greater recognition for employee mobility considerations. In *Ascension Insurance Holdings v. Alliant Insurance and Roberts Underwood*, 2015 Del. Ch. LEXIS 19 (January 28, 2015), for instance, a Delaware company sought to enforce a non-competition provision in an agreement that it had signed with a California employee in which the parties had consented to Delaware venue and application of Delaware law for any disputes. The Delaware Chancery Court, however, declined to enforce the Delaware choice of law provision, holding that California had a greater interest in the action, and California public policy would be violated if Delaware law were applied under which the non-competition provision would be enforceable. More recently, another Delaware Chancery Court in *EBP Lifestyle Brands Holdings v. Boulbain*, 2017 Del. Ch. LEXIS 143 (August 4, 2017), refused to enforce against a California employee a non-competition provision in an agreement where the parties had similarly agreed that Delaware law would apply to disputes.

Many employers have been left to ask the question, can we lawfully do anything to protect our significant investments in our people who, by the way, often carry with them our most competitively sensitive IP? The answer is YES.

The vast majority of states in the United States still enforce against employees non-competition agreements that are reasonable in scope. Restrictive covenants with individual employees less than non-competition agreements, e.g., employee non-solicitation agreements, still appear to be universally enforceable. Employers everywhere are still free to require employees to sign confidentiality and non-disclosure agreements to protect employers' most sensitive information. The UK concept of Garden Leave seems to be slowly making its way to United States.

Further, it is worth noting that even the Antitrust Division has recognized (as reflected in the excerpt from its 2011 Consent Decree with several high-tech companies in the Silicon Valley, https://www.justice.gov/atr/case-document/final-judgment-0) that there are situations where employee non-solicitation provisions are permissible, including when:

1. Contained within existing and future employment or severance agreements with an employer;
2. Reasonably necessary for mergers or acquisitions, consummated or unconsummated, investments, or divestitures, including due diligence related thereto;
3. Reasonably necessary for contracts with consultants or recipients of consulting services, auditors, outsourcing vendors, recruiting agencies, or providers of temporary employees or contract workers;
4. Reasonably necessary for the settlement or compromise of legal disputes; or
5. Reasonably necessary for (i) contracts with resellers or OEMs; (ii) contracts with providers or recipients of services other than those enumerated in paragraphs 1-4 above; or (iii) the function of a legitimate collaboration agreement, such as a joint development, technology integration, joint ventures, joint projects (including teaming agreements), and the shared use of facilities.

Terms such as "reasonably necessary" may leave room for interpretation, but to date, the Antitrust Division has not focused on challenging employee non-solicitation agreements in any of the above areas. Indeed, the Antitrust Division mentions in its October 2016 advisory guidance that no poaching agreements that are reasonably necessary to a larger legitimate collaboration between employers, including legitimate joint ventures, are not considered per se illegal under the antitrust laws.

In sum, while employers need to tread carefully lest they fall into the cross-hairs of the DOJ Antitrust Division, all is far from lost for employers increasingly concerned about how to retain their most prized people and IP assets.

TAKEAWAYS

- Non-disclosure, non-compete, and non-solicitation agreements with individual employees are aspects of an effective IP protection program and are enforceable in most states.
- But don't assume that courts will reflexively enforce restrictive covenants simply because an employer and employee agree to them in a contract or that you can avoid antitrust problems just because you explain to the affected employees what you are doing, even if they agree to it.
- Beware that employee wages may be considered akin to prices for products and services, so entering into non-solicitation and similar agreements (particularly about setting wage rates) with other companies may violate antitrust law.
- Look at your compliance program to be sure it covers HR issues; include HR personnel in the training and consider whether written materials need updating.
- Continuing competition won't stem prosecution if there is an agreement on some phase of the process that is not ancillary and required for a legitimate, procompetitive purpose. For example, with agreements to avoid use of certain types of benefits or to set benefit levels, the companies may be vigorously competing for employees, but the conduct could still be criminal.
- If you find a problem that was not terminated before October 2016, you may want to consider an application under the Antitrust Division's Leniency Policy, which provides for criminal amnesty for the first to disclose an antitrust violation (https://www.justice.gov/atr/leniency-program).

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2 https://www.educba.com/employee-most-valuable-intangible-assets/.

3 https://www.justice.gov/sites/default/files/dag/legacy/2010/08/23/intellectual-property-spotlight.pdf.

4 https://www.infosecurity-magazine.com/news/employees-dont-think-twice-about-stealing/.

5 *U.S. v. eBay, Inc.*: https://www.justice.gov/atr/case/us-v-ebay-inc; *U.S. v. Lucasfilm Ltd.*: https://www.justice.gov/atr/case/us-v-lucasfilm-ltd; *U.S. v. Adobe Systems, Inc.*: https://www.justice.gov/atr/case/us-v-adobe-systems-inc-et-al.

6 https://www.justice.gov/atr/file/903511/download. The Guidance provides some history on enforcement, details the law and its application, and provides tips to avoid problems.

7 https://www.justice.gov/opa/pr/justice-department-requires-knorr-and-wabtec-terminate-unlawful-agreements-not-compete.

8 http://antitrust.bna.com/atrc/.

9 https://www.justice.gov/opa/pr/justice-department-requires-knorr-and-wabtec-terminate-unlawful-agreements-not-compete.

10 https://www.congress.gov/115/bills/hr5631/BILLS-115hr5631ih.xml.

11 https://www.congress.gov/bill/115th-congress/senate-bill/2480/text.

12 https://malegislature.gov/Bills/190/H4868.pdf.