



Not Just Non-Competes: How Proposed Non-Compete Bans Could Affect NDAs, Trade Secrets, and More

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Open Source Software, Patents, and the Question of Compatibility
Wednesday, April 5, 2023 | 1:30 - 2:30 p.m. ET


Open source software has become an integral part of the software development industry. Leveraging the combined skills of an open source developer community often leads to improved time-to-market and lower costs for both development and support. However, open source software communities have adopted a wide range of licenses and patent policies, some of which can conflict with business objectives. In addition, innovators often view open development and patenting as incompatible, which can create challenges for companies attempting to create strategic patent portfolios.


On Wednesday, April 5, please join [Adam Kessel](#), [Eric Schulman](#), and [David Kaminsky](#) for a discussion about the intersection of open source software and intellectual property.

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PRESENTED BY:


[Adam Kessel](#)
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Litigation Technology Analyst

WHAT YOU'LL LEARN

Adam, Eric, and David will discuss the following topics and more:

- Issues associated with open source software use
- How companies can deploy innovative business and legal strategies to reconcile the seeming conflict between open development and patents
- A survey of various collaborative patent organizations

Types of Post-employment Restrictions

Terminology varies but there are three basic types of agreements:

- **Covenant not to Compete:** A post-employment restriction on the type, geographic area, and duration of time in which an employee will not take a competitive position.
- **Non-Solicitation Agreement:** A post-employment restriction that is a type of non-compete to protect trade secrets or another compelling interest of the employer by preventing:
 - Solicitation of employer's customers after an individual's employment ends.
 - Solicitation of other employees after an individual's employment ends.
- **Non-Disclosure Agreement:** a restriction on an employee prohibiting disclosure of trade secret and confidential information of the employer that extends throughout employment and the post-employment so long as such information remains confidential or for a period of years.
- Definitions and parameters for **each type** of Agreement varies by jurisdiction.

Employer – Covenants Not To Compete Vary By State

- **Employee Covenant Not to Compete (CNTS)**

- **California**: Section 16600 - Contract by which an employee is restrained from engaging in a lawful profession, trade, or business of any kind. Ca. Bus. and Prof'l. Code § 16600. Unenforceable
- **Texas**: Not defined in Texas Statute, Tex. Bus. & Com. Code Section 15.50(a). Favors enforcement.
- **Florida**: Contracts that restrict or prohibit competition during or after the term of restrictive covenants...Florida Statutes 542.335(1)...Favors enforcement
- **New York**: “A non-competition agreement (“non-compete”) prohibits an employee from working for a competitor or opening a competing business, typically for a certain period of time after an employee leaves a job....” N.Y. Attorney General, “Non-Compete Agreements In New York State Frequently Asked Questions”. Qualified enforceability.
- **Pennsylvania**: Common law rules regarding restriction on an employee post-employment. Qualified enforceability.

“Blue Penciling”

- **Blue penciling** permits a court to modify a non-compete to make its restraint on an employee reasonable rather than voiding it.
- For example, Texas Business and Commerce Code § 15.51(c), if the duration or geography are unreasonable, “*the court shall reform the covenant* to the extent necessary to cause the limitations contained in the covenant as to time, geographical area, and scope of activity *to be restrained to be reasonable and to impose a restraint that is not greater than necessary to protect the goodwill or other business interest of the promisee* and enforce the covenant as reformed”
- Other blue pencil states include **Arizona, Delaware, Florida, Kentucky, Nevada, North Carolina, etc.**

What are legitimate purposes of non-competes

- The primary justification for non-competes is protection of trade secrets
- Non-disclosure agreements protect trade secrets without preventing workers from changing jobs in the same industry or location.
- Employees have no legitimate interests in being able to use former Employer's trade secrets in another business.
- Employers have no legitimate interests in:
 - Inhibiting movement of Employees
 - Reducing competition for Employees
 - Impairing customers from shopping for products and services
 - Raising barriers to entry into a market

A movement to eliminate post-employment restrictions?

There is growing hostility to post-employment restrictions:

- Restrictions in employment contracts have become rampant even when no real justification exists for them, impacting even low wage – unskilled workers.
- Restrictions have become over-broad barriers to employee mobility.
- Even void or defective restrictions are harmful because they intimidate unsophisticated employees as well as employees who cannot afford counsel.
 - The threat or filing of litigation by an employer will often result in employees living with an unenforceable non-compete or force an employee to capitulate when challenged.
 - Likewise, start-ups and young companies may not have the funds or time to litigate to retain an employee and/or risk damages for trade secret misuse.

FTC Finds Non-Competes An Unfair Method of Competition

- Approximately 30 million U.S. workers are covered by non-compete clauses
- 53% of workers covered by non-competes are hourly employees.
- Non-compete clauses depress wages for all workers because they inhibit movement for employees who are under non-competes, which results in less opportunity for those who do not have non-competes.
- Non-competes inhibit business formation by limiting the pool of available workers and foreclosing employees from starting new businesses in their fields – new business are biggest source of new jobs.
- Non-competes raise prices for products and services because they inhibit competition in markets by stagnating movement and hiring of employees among competitors.
- Trade secret non-disclosure agreements service legitimate ends of non-competes without foreclosing worker mobility and make non-competes unnecessary.

Momentum for Change?

Timing

- **Federal Action targeting post-employment restrictions**
 - January 5, 2023, FTC votes to publish proposed rule in Federal Register dramatically limiting CNTCs nationwide.
 - July 1, 2021 Executive Order, Executive Order on Promoting Competition in the American Economy, urged FTC to use rule-making authority “to curtail the unfair use of non-compete clauses and other clauses or agreements that may unfairly limit worker mobility.” At § 5(g).
 - January 9, 2020 FTC workshop on post-employment restrictions, call for comments.
 - November 19, 2019, Attorneys General of Minnesota, California, Delaware, District of Columbia, Illinois, Iowa, Maine, Massachusetts, Maryland, Michigan, New Mexico, North Carolina, Oregon, Pennsylvania, Rhode Island, Vermont, Virginia, Washington and Wisconsin, send joint letter to FTC urging it to use its rule-making authority to curtail post-employment restrictions.
- **States limiting or eliminating post-employment restrictions :**
 - California has had a long-standing rule against CNTC, Cal. Bus. & Prof. Code, § 16,600, as have Oklahoma and North Dakota.
 - Other States have put certain limits on post-employment CNTC in the last decade: Colorado, District of Columbia, Hawaii, Illinois, Maine, Maryland, Massachusetts, Nevada, New Hampshire, Oregon, Rhode Island, Washington State.
 - Legislation limiting CNTC pending now in Connecticut, Indiana, New York, Rhode Island and Utah.
 - Trend to void non-competes for hourly, non-exempt and low wage workers.

FTC Proposed Rule Banning Non-Compete Clauses

“The Truth Is In The Details” – Stephen King

SUBCHAPTER J—RULES CONCERNING UNFAIR METHODS OF COMPETITION PART 910—NON-COMPETE CLAUSES

Sec.

910.1.Definitions.

910.2.Unfair methods of competition.

910.3.Exception.

910.4.Greater protection under State law.

910.5.Effective date and compliance date.

Authority: 15 U.S.C. 45 and 46(g).

Definitions Are Critical To Understanding The Rule

(b) Non-compete clause.

- (1) **Non-compete clause** means a **contractual term** between an employer and a worker that prevents the worker from seeking or accepting employment with a person, or operating a business, after the conclusion of the worker's employment with the employer.
- (2) **Functional test** for whether a contractual term is a non-compete clause. The term non-compete clause includes a contractual term that is a de facto non-compete clause because it has the effect of prohibiting the worker from seeking or accepting employment with a person or operating a business after the conclusion of the worker's employment with the employer. For example, the following types of contractual terms, among others, may be de facto non-compete clauses:
 - i. **A non-disclosure agreement** between an employer and a worker that is written so broadly that it effectively precludes the worker from working in the same field after the conclusion of the worker's employment with the employer.

When Is An NDA Functionally A Non-Compete?

FTC functional test is similar to Cal. Bus. & Prof. Code §16,600, **which bars restraints** on an employee's ability to engage in a profession, trade or business:

- “Except as provided in this chapter, **every contract** by which anyone is restrained from engaging in a lawful profession, trade, or business of any kind is to that extent void.”
- California cases hold that non-disclosure (confidentiality) agreements are permissible so long as they are necessary to protect the employer's trade secrets, are tailored to do so, and are limited in time.
 - *Perpetual confidentiality agreement has been held void.*
 - *Non-solicitation and confidentiality agreements held void as overbroad when the employee's sole trade was as a recruiter for the same type of employees as his employer and where employee list was not trade secret.*
 - *When non-compete and confidentiality are intertwined in one clause or indivisible in one contract, the entire contract can be void.*
- California case law further permits for preliminary injunctions to protect confidentiality under trade secret tort law, even if contract is or could be a restraint.

Use Trade Secret Misappropriation As A Template For Your Confidentiality Agreement?

- Tort claims for trade secret misappropriation held not to fall under Section 16,600.
- **Draft the NDA as a separate document in effect pleading trade secret tort claim?**

Consider? Employer has developed the following information that it keeps confidential which is not generally known in its industry, provides it with a competitive advantage in its business over others who do not know it, and are trade secret as defined in 18 U.S.C. § 1839(3) . If any of the following information is published, or disclosed to or used for a competing business, Employer would be harmed. To protect the confidentiality of the following information and Employer's business, Employee agrees to keep the following information confidential and only use it in Employer's business so long as the information remains secret, or for ____ years after the conclusion of employment:

[List trade secrets the Employee will be exposed to, **and update as Employee changes positions**]

- **Formulas and manufacturing processes for chemical products developed by Employer for fracking oil and gas wells.**
- **Formulas and manufacturing processes for chemical products developed by Employer as fire retardants to enhance safety in drilling oil and gas wells.**
- **Its customers purchasing preferences, including specific products, volumes and pricing, for fracking as necessary for each of Customers' oil and gas drilling sites.**

Is Inevitable Disclosure Functionally A Non-Compete?

- **Inevitable disclosure is available in some states in trade secret cases, but if no evidence is required other than similarity of positions or duties, does it make an NDA functionally a non-compete?**
 - Former Pepsi Co. general manager of large regional soft drink division was recruited by competitor to take over its competing soft drink division to implement the same systems it put in place at Pepsi.
 - General manager made preparations to take trade secrets from Pepsi to use at new job and lied about it.
 - “Redmond's lack of forthrightness on some occasions, and out and out lies on others, in the period between the time he accepted the position with defendant Quaker and when he informed plaintiff that he had accepted that position leads the court to conclude that defendant Redmond could not be trusted”
- **The “inevitable disclosure” doctrine properly applied is actually narrow and based on**
 - 1) the high-level position of the employee,
 - 2) management/strategic planning jobs that are directly competitive and focused same tasks/projects/duties.
 - 3) manager has incentive improve his business unit’s competitive position, and
 - 4) **manager deceitful in hiding his intentions and taken steps to misuse trade secrets.**

PepsiCo, Inc. v. Redmond, 54 F.3d 1262, 1270 (7th Cir. 1995)

Non-Solicitation As Functional Non-Compete?

Since non-solicitation is typically seen as a type of non-compete, can it be justified on another basis?

- **Trade secrets?**

- Are **customers** obvious?
 - E.g. Veterinary supply business can look up veterinarians in a local to identify customers.
- Is it not the customer's identity but the terms of its deal, purchasing patterns and/or product needs that are the valuable information?
- Are **employee qualifications and/or experience public information?**
 - LinkedIn?
 - Meet up groups?
- Are **pay/benefit ranges known?**
 - Social media – Glassdoor?
 - Advertised in employment adds?

When Are Non-Competes Agreement Acceptable?

- **Senior highly compensated executives** have knowledge, bargaining power, and access to counsel
- **Business Sale:** Hard assets + Intellectual Property + Goodwill
 - Goodwill is amorphous, hard to transfer, hard to value.
 - Goodwill is generally measured as the difference between the purchase price and value of the assets of the sold business.
 - Transfer of trademarks, trade dress, customer information
 - But also, may require owners/operators to commit not to compete, including solicitation of customers and employees to give the buyer benefit of its bargain.
 - Lower risk of abuse because B2B generally reduces imbalance in negotiations between buyer and seller.

FTC - Existing Non-Competes Rescinded?

- **The new rule requires an employer that entered into a non-compete clause with a worker prior to the compliance date must rescind the non-compete clause no later than the compliance date.**
 - The difficulty and cost of notice could be substantial, especially for former employees subject to non-compete agreements, especially by the “compliance date” ultimately set by the FTC.
 - What about *functional equivalents subject to being deemed* non-compete agreements?
- **Rescission is a broader remedy than rendering a non-compete unenforceable on the because the legal effect of rescission is as if the non-compete never existed.**
- **Rescission may require that the parties be restored to the same position as if the non-compete never existed:**
 - Retroactively eliminate employee non-competes in litigation?
 - Or subject to past settlements?
 - Create claims for damaged employees?
 - What about the Contract Clause? It only applies to States, not the Federal Government.
 - What about prohibition on *Ex Post Facto* Laws? Generally, only applies to criminal laws.

Workforce Mobility Act of 2023: SB 220 & HB 731

- **Workforce Mobility Act of 2023: Eliminates covenants not to compete by statute.**
- **Exempts trade secret non-disclosure agreements**
- **Based on broad findings:**

(1) The proliferation of noncompete agreements throughout sectors, occupational categories, and income brackets is contrary to the commitment of Congress to foster stronger wage growth for workers in the United States. Economists now estimate that 1 in 5 workers is covered by a noncompete agreement.

(2) Noncompete agreements are blunt instruments that crudely protect employer interests and place a drag on national productivity by forcing covered workers to either idle for long periods of time or leave the industries in which the workers have honed their skills altogether.

(3) Enforceable noncompete agreements also reduce wages, restrict worker mobility, impinge on the freedom of a worker to maximize labor market potential, and slow the pace of innovation in the United States.

(4) Employers have access to legal recourses to protect their legitimate interests and property, including trade secret protections, intellectual property protections, and nondisclosure agreements that do not inflict broad collateral harm on the labor market prospects for workers.

(5) Employers that rely on a list or lists of vendors, customers, or clients that are not easily obtained by an individual through means other than the work relationship have adequate legal protection through the use of trade secret protections and nondisclosure agreements.

(6) Noncompete agreements broadly restrict employment options for workers in the United States when more narrowly targeted remedies are readily available to employers. ...

...

Worker Mobility Bill Context

- Reintroduction of Worker Mobility Act of 2021
- Has some bipartisan support in both houses of Congress
- Authorizes enforcement by FTC and Department of Labor (DOL)
- Authorizes private civil causes of action for compensatory damages
- Voids enforceability of arbitration clauses and waivers of joint/class action clauses
- Permits suits by individuals, joint-class actions, *parens patriae* by state attorneys generals

Comparison of the Bills to FTC Proposed Rule

Permits for both agency and employee lawsuits for enforcement and damages	Agency enforcement only – no damages
<ul style="list-style-type: none">▪ Provides for FTC and Labor Dpt. enforcement AND employee civil actions for damages▪ Non-competes unenforceable not rescinded▪ Claims permitted on an individual, class or <i>parens patriae</i> basis▪ No arbitration or joint action waiver▪ Only applies to non-competes▪ Does not apply to trade secret agreements (NDA)▪ Individual notice is not required	<ul style="list-style-type: none">▪ Only FTC can enforce, not DOL▪ Applies to all restraints on employee's ability to work in their field: functionally equivalent contracts (e.g., overly broad NDA).▪ Requires rescission▪ Requires individual notice to past and present employees by a "compliance date"▪ No civil suits by or for employees or their damages

Non-Compete Regulation in Europe: Not so much ...

- Regulation of non-competes generally is considered an antitrust or competition issue to preserve competition in relevant markets more so than labor regulation.
- FTC and EU Competition Authority operate in a synergistic way: Following each others' work, even sharing information and coordinating positions. For example, this is very much in evidence in antitrust/competition enforcement in policing licensing of standard essential patents. EU Competition authority is watching FTC developments.
- European labor markets, customs, practices, and regulations are country specific.
- Regulation of non-competes in Europe is on an individual country, not EU wide basis.
 - In Germany, regulation of non-competes goes back as far as 1897, Italy 1942
 - In Netherlands no substantive regulation
 - In France court cases provide some limits
 - Other countries have case law that acts as some measure of regulation.



Closing Comments



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