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Trade secrets and the death of non-competes

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Pursuant to the Federal Trade Commission Act ('FTC Act"), the Federal Trade Commission is issuing the Non-Compete Clause Rule ("the final rule") effective Sept. 4, 2024, based upon findings in a 165-page report. (https://bit.ly/3UUYyQU).

The necessity to use non-competes to protect trade secrets has been rejected by the FTC. Years ago, non-competes may have been necessary but not today. The modern law of trade secrets provides employers with a viable, well-established means for protecting trade secrets, without the need to resort to using non-competes with the attendant harms to competition.

Non-competes

The FTC claims that post-employment provisions have been used to block workers from freely switching jobs, suppressing wages, hampering innovation, and blocking entrepreneurs from starting new businesses.

The FTC estimates that a ban on non-competes will expand career opportunities for 30 million Americans and increase wages by nearly $300 billion annually. See the FTC Press Release, Jan. 5, 2023.

The final rule provides that it is an "unfair method of competition" for employers to enter into non-compete clauses with workers on or after Sept. 4, 2024. The final rule defines "worker" as "a natural person who works or who previously worked, whether paid or unpaid, without regard to the worker's title or the worker's status under any other State or Federal laws, including, but not limited to, whether the worker is an employee, independent contractor, extern, intern, volunteer, apprentice, or a sole proprietor who provides a service to a person."

The FTC proposed the Non-Compete Clause Rule on Jan. 19, 2023, pursuant to Section 5 of the FTC Act (15 USC 45) based on the Commission's expertise, empirical research, and over 26,000 public comments. The FTC adopted the final rule effective Sept. 4, 2024.

There have been two court challenges.

On July 3, 2024, the U.S. District Court for the Eastern District of Texas in *Ryan, LLC v. FTC*, issued a preliminary injunction staying the effective date of the FTC's non-compete rule against one plaintiff and four plaintiff-intervenors, but the Ryan court has declined to issue a nationwide injunction.

On July 23, 2024, the U.S. District Court for the Eastern District of Pennsylvania in *ATS Tree Services v. FTC* denied the plaintiff's motion for a nationwide preliminary injunction staying the effective date of the FTC's non-compete rule. The district court found that the plaintiff had failed to demonstrate that it was likely to prevail on its claim that the FTC's rule was unlawful.

Non-compete clause means: (1) A term or condition of employment that prohibits a worker from, penalizes a worker for, or functions to prevent a worker from: (i) Seeking or accepting work in the United States with a different person where such work would begin after the conclusion of the employment that includes the term or condition; or (ii) Operating a business in the United States after the conclusion of the employment that includes the term or condition. (2) For the purposes of this part, term or condition of employment includes, but is not limited to, a contractual term or workplace policy, whether written or oral.

The modern law of trade secrets provides employers with a viable, well-established means for protecting trade secrets, without the need to resort to using non-competes with the attendant harms to competition.

The final rule provides that, for a worker other than a senior executive, it is an unfair method of competition for a person to enter into or attempt to enter into a non-compete clause; to enforce or attempt to enforce a non-compete clause; or to represent that the worker is subject to a non-compete clause.

The FTC has adopted a special exception for senior executives with existing non-competes. Senior executive means a worker who: (1) Was in a policy-making position; and (2) Received from a person for the employment: (i) Total annual compensation of at least $151,164 in the preceding year; or (ii) Total compensation of at least $151,164 when annualized if the worker was employed during only part of the preceding year; or (iii) Total compensation of at least $151,164 when annualized in the preceding year prior to the worker's departure if the worker departed from employment prior to the preceding year and the worker is subject to a non-compete clause.

For a senior executive, it is an unfair method of competition for a person to enter into or attempt to enter into a non-compete clause;

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to enforce or attempt to enforce a non-compete clause entered into *after* the effective date; or to represent that the senior executive is subject to a non-compete clause, where the non-compete clause was entered into *after* the effective date.

Prohibiting the use of non-compete clauses will have no negative impact on trade secrets law.

Existing non-competes with senior executives can remain in force; the final rule does not cover them. For workers who are not senior executives, existing non-competes are no longer enforceable after Sept. 4, 2024. Employers must provide such workers with notice that the non-competes will **not** be enforced after September 4, 2024.

Trade secrets

The Uniform Trade Secrets Act ("UTSA") provides a civil cause of action for the actual or threatened misappropriation of trade secrets. The UTSA also provides for injunctive and monetary relief, including compensatory damages, punitive damages, and attorney fees. Every state (except New York) has enacted the UTSA.

In 2016, Congress enacted the Defend Trade Secrets Act ("DTSA"), which provides a civil cause of action in federal court for trade secret misappropriation. In addition, there is a provision for *ex parte* seizure orders to protect against the threatened misappropriation of trade secrets. Based upon a sworn affidavit or verified complaint, in extraordinary circumstances, the trial court can issue an order for the immediate seizure of property (computers, thumb drives, etc.) necessary to prevent the propagation or dissemination of plaintiff's trade secrets.

Trade secret theft is also a federal criminal offense. The Economic Espionage Act of 1996 ("EEA") makes it a federal crime to steal a trade secret for either (1) the benefit of a foreign entity ("economic espionage") or (2) the economic benefit of anyone other than the owner ("theft of trade secrets"). In addition to fines and imprisonment, the EEA requires the trial court to order that the defendant forfeit any property constituting, or derived from, any proceeds the defendant obtained, directly or indirectly, as a result of the EEA offense.

The UTSA, DTSA and EEA provide a much stronger foundation for the protection of trade secrets than the use of non-competes. Historically, non-competes have been void in California, North Dakota and Oklahoma since the 1800s. There is no evidence that employers in these states could not protect trade secrets. For example, California is home to four of the world's 10 largest companies with the most vibrant startup culture in the United States.

Over 26,000 public comments expressed support for the FTC's proposal to ban non-competes. Participants weighed in with comments that non-competes have suppressed their wages, harmed working conditions, negatively affected their quality of life, reduced the quality of the product or service their company provided, prevented their business from growing and thriving, and created a climate of fear that deters competitive activity.

Prohibiting the use of non-compete clauses will have no negative impact on trade secrets law. Employers will now take advantage of the UTSA, DTSA and EEA to establish policies, practices and procedures for the identification, classification, protection, and valuation of trade secret assets.

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