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Non-Compete Clauses Under Fire: Reassess Your Patent, Trade Secret and Non-Disclosure Agreement Strategies Now

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In a Notice of Proposed Rulemaking ("NPRM") issued on January 5, 2023 and discussed in our recent alert, the Federal Trade Commission ("FTC") proposed a new rule that, if adopted as is, will ban employers from entering into or maintaining existing non-compete clauses with "workers" (*e.g.*, employees and independent contractors) or otherwise representing to a worker that they are bound by a non-compete clause.

As proposed by the FTC, employers would have 180 days to comply after publication of the final rule in the Federal Register. Those six months are the final opportunity for employers to rescind existing non-competes, remove non-compete language from employee handbooks and to-be-executed worker agreements, and develop or enhance alternative forms of permitted protection.

This alert focuses on the alternative forms of protection that will still be permitted if this proposed rule is adopted: non-disclosure agreements (NDAs), client or customer non-solicitation agreements, patents and trade secrets. In particular, the FTC notes that while non-compete clauses would be banned, the definition of non-compete would

> generally ***not*** include other types of restrictive employment covenants—such as [NDAs] and client or customer non-solicitation agreements—because these covenants generally do not prevent a worker from seeking or accepting employment with a person or operating a business after the conclusion of the worker's employment with the employer.

The NPRM also positively notes that many employers already protect their confidential information and intellectual property through the use of NDAs, filing patents, identifying trade secrets and employing reasonable measures to protect them. The NPRM explicitly encourages employers to utilize these alternative forms of protection while acknowledging that they "may not be as protective as employers would like," but suggest that "they reasonably accomplish the same purposes as non-compete clauses while burdening competition to a less significant degree."

Although many of our clients utilize NDAs, and employee and customer non-solicitation agreements with their workers, not all of them have implemented robust intellectual property identification and protection programs. At this point, the NPRM has an uncertain outcome, but if the FTC's proposed non-compete ban is implemented, 180 days may not be enough time to ensure that your intellectual property, customer relationships, confidential information and trade secrets remain reasonably protected. Below we outline some steps you may want to consider pursuing now to assess whether these other forms of alternative protection may be right for your business.

NDA and Non-Solicitation Agreement Audits

Auditing NDAs and customer and employee non-solicitation agreements has two main components: (1) reviewing the scope of the non-disclosure and/or non-solicitation agreements to ensure they are well-drafted, provide the appropriate scope of protection and comply with applicable state law; and (2) ensuring that the correct form of agreement is in place and matched with the right level and type of your employees. In reviewing the scope of these agreement, the audit evaluates what agreements are currently in place with respect to each class of employees, reviews what types of information your company treats or designates as confidential information, assists with refining or tailoring those categories, assesses the appropriate temporal duration and otherwise evaluates whether these agreements are sufficient to

reasonably protect your confidential information. This process may also help your business distinguish between what information is confidential and what information may properly designated and protected as a trade secret. In certain instances, businesses may seek to add or modify governing law, venue and attorneys' fee-shifting provisions to these agreements to simplify or enhance subsequent enforcement efforts. Finally, these agreements should also be reviewed to ensure compliance with laws that require employers to provide notice of certain exceptions to non-disclosure requirements, such as whistleblower immunity, or forfeit certain, otherwise-available remedies.

Patent Audits

Auditing a business's patent protection efforts may be more complicated, but is often worthwhile and will likely provide a valuable layer of added protection if the FTC bans non-compete clauses. Patent rights have generally been strengthened over the last 20 years while the cost of obtaining a patent has not increased significantly. Businesses that previously dismissed patents as being "out of reach" perhaps due to their perceived costs or other perceived roadblocks are finding out that their competitors may have received patents on similar designs and/or technologies. The threshold for utility patent protection is far lower than most believe. In fact, a number of well-known businesses have thrived based on patent protection covering little more than an incremental improvement of an existing product or process. The availability of design patent protection has also expanded in the last decade to cover not only new, non-obvious ornamental design for physical products (e.g., containers/bottles, electronic appliances, kitchen gadgets, toys), but also the graphics displayed on the screen of an electronics device. A patent audit involves identifying and evaluating designs/technology that may still be eligible for patent protection. (One significant hurdle to filing a patent is the one-year deadline following public disclosure and/or initial sales effort of the invention.) Patent audits often further involve the creation of policies and procedures to identify and maintain patents going forward. The audit may also include worker training on patents to help workers recognize when patenting opportunities may arise. The opportunities that may be identified through a patent audit may provide benefits to a business well beyond the use of patents as reasonable substitutes for non-competition clauses.

Trade Secret Audits

The FTC notes in the NPRM with particular interest that "[t]rade secret law has developed significantly in recent decades" particularly through the adoption by 47 states of the Uniform Trade Secrets Act and the more recent enactment of the federal Defend Trade Secrets Act ("DTSA") that provides federal civil and criminal penalties for trade secret misappropriation. The DTSA, in particular, authorizes courts in "extraordinary circumstances" to issue civil *ex parte* orders for the "seizure of property necessary to prevent the propagation or dissemination of the trade secret that is the subject of the action." In the six years since enactment of the DTSA there have been a significant number of successful *ex parte* seizure motions. This further emphasizes the opportunity that trade secrets present as a substitute for non-competition clauses.

A trade secret audit has two main components: (1) identifying a business's trade secrets and (2) ensuring that those trade secrets are subject to "reasonable efforts" to maintain their secrecy. According to the DTSA, a "trade secret" can be almost anything (i.e., "all forms and types of financial, business, scientific, technical, economic, or engineering information") so long as the information is valuable because it has been kept secret from others "who can obtain economic value from the disclosure or use of the information." Trade secrets are frequently identified in audits by reviewing a company's business plans, contracts (especially lists of purchased assets and statements of work), customer and supplier lists, pricing information, software and standard operating procedures, among other sources.

What constitutes "reasonable efforts" to maintain secrecy depends on the nature of each trade secret and the relative size of the business. For example, having NDAs with workers, password-protected computer systems, and a physically secure place of business where the secrets reside will be sufficient to be deemed reasonable. In other instances, more may be required. Thus, a trade secret audit involves assessing companywide security measures, including physical security, systems security, data security, and control over third party access, including legal protections. This will likely also include an examination of how a business safeguards confidential information and trade secrets when there is a departing worker.

Identifying trade secrets and closing any unreasonable gaps in protection is the primary focus of a trade secret audit and should be a priority for businesses in the wake of the FTC's proposal to ban non-compete clauses. Trade secret audits often further involve the creation of policies and procedures to identify and maintain trade secrets going forward. The audit may also include worker training on trade secrets to help them recognize trade secrets when they arise. Given the complementary nature of trade secret and patent protection, the identification efforts, created policies/procedures, and worker training associated with each type of audit overlap significantly.

Finally, trade secret audits provide an impetus to schedule interviews with key employees for their help in identifying trade secrets and evaluating current efforts to maintain secrecy. These interviews offer another opportunity to discuss trade secret policies and NDAs. These efforts have the added benefit of making it harder for workers to argue in defense of post-employment trade secret enforcement efforts that they were not aware that the business had certain trade secrets or took reasonable measures to protect its trade secrets. The audit also provide a concrete and constructive response to the recent uptick in courts questioning the value of a trade secret that was never "written down" or otherwise recognized by the company.

In its Notice of Proposed Rulemaking, the FTC recognized that auditing a business's performance with respect to these alternative forms of protection will take time. Those businesses that decide to conduct these audits before the 180-day clock starts will be ahead of the curve. In fact, even if the rule is defeated, most businesses will still find these audits to be extremely valuable.

If you have any questions, please reach out to **Jordan Sigale** at jsigale@vedderprice.com or the Vedder Price lawyer(s) you normally work with.

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