Protecting Your Company:
Critical Developments in Trade Secrets & Restrictive Covenants

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Agenda

- California's New Law
- State & Federal Landscape
- Implications of California's New Law
- Trade Secrets
- Best Practices

California’s New Law

California

- It is well known that in CA: ***"every contract by which anyone is restrained from engaging in a lawful profession, trade, or business of any kind is to that extent void."*** Cal. Bus. & Prof. Code § 16600.
- Senate Bill 699 and Assembly Bill 1076 are now in effect and further restrict the enforcement of employment non-compete agreements.
- These laws also expand the scope of remedies.

Overview of SB 699

- SB 699 added § 16600.5 to Cal. Bus. & Prof. Code
- Makes non-compete void regardless of where and when the contract was signed. § 16600.5(a)
- Prohibits employer/former employer from attempting to "to enforce a contract that is void" under the law "regardless of whether the contract was signed and the employment was maintained outside of California." § 16600.5(b).
- Prohibits employer from entering "into a contract with an employee or prospective employee that includes a provision that is void." § 16600.5(c).
- Makes employer civilly liable if it "enters into a contract that is void" or "attempts to enforce a contract that is void." § 16600.5(d).
- Authorizes existing, former or prospective employees to file private action for injunctive relief, damages and obtain attorneys fees and costs if a prevailing party. § 16600.5(e).

Overview of AB 1076

- AB 1076 amended § 16600 to make it clear that § 16600 "shall be read broadly, in in accordance with Edwards v. Arthur Andersen LLP (2008) 44 Cal.4th 937, to void the application of any non-compete agreement in an employment context, or any non-compete clause in an employment contract, no matter how narrowly tailored, that does not satisfy an exception in this chapter." § 16600 (b)(1).
- Clarified that § 16600 (b) did "not constitute a change in, but is declaratory of, existing law."
- Added § 16600.1 making it unlawful to include a non-compete clause in an employment setting or requiring an employee to enter into a non-compete. § 16600.1 (a).
- Required notice to employees no later than February 14, 2024 for current and former employees employed after January 1, 2022 whose contracts contained a non-compete clause or who had entered into a non-compete that such clauses or agreements were void. § 16600.1 (b)(1).
- Stated that violation is considered an act of unfair competition within the meaning of Chapter 5. § 16600.1 (c).

California Lawsuits Have Quickly Followed

- *CG Enterprises Holdings, LLC v. WSP USA, Inc.*, No. 3:24-cv-00292, ECF No. 1-1 (N.D. Cal.)
  - 1/1/2024: Lawsuit filed by a former employee residing in Arizona and the California company that wanted to hire him seeking declaratory and injunctive relief to prohibit his former employer from enforcing a non-compete.
- *Massi v. RSC Ins. Brokerage, Inc.*, No. 24VECV00118 (Los Angeles Superior)
  - 1/9/2024: Former employee of RSC filed suit to void the non-solicitation provisions of his employment agreement.
- *Buchholz v. Air Methods Corp.*, No. 1:24-at-00093, ECF No. 1 (E.D. Cal.)
  - 1/30/2024: Former employee of Air Methods filed suit seeking a declaratory judgment that the non-compete and non-solicitation agreement she signed prior to her resignation was void and unenforceable.

California Lawsuits Have Quickly Followed

- *Hermalyn v. DraftKings, Inc.*, No. 24STCV02694 (Los Angeles Superior Court)
  - 2/1/2024: Former DraftKings employee Hermalyn and his new employer, Fanatics VIP, requested a declaratory judgment that: (i) Hermalyn may freely compete against DraftKings, including by working as the President of Fanatics VIP and the Head of Fanatics' Los Angeles, California, office; (ii) Fanatics VIP may continue to employ Hermalyn in this capacity; (iii) Hermalyn's post-employment restrictive covenants with DraftKings, including the non-compete, client non-solicit and no-service, and employee non-solicit and no-hire prohibitions, are void and unenforceable under Sections 16600, 16600.5, and 16600.1 Cal. Bus. & Prof Code; and (iv) the Massachusetts choice of law and forum provisions are void and unenforceable under California law and public policy.
- *Davis v. Empire Chauffer Serv. Ltd.*, No. 24STCV03861 (Los Angeles Superior)
  - 2/15/2024: Former employee filed a PAGA action that alleged the non-compete and non-solicitation provisions in his agreement violated Sections 16600 et. seq. of Cal. Bus. & Prof Code, and thus violated California Labor Code Section 432.5, which prohibits employers from requiring employees to agree to any term that is prohibited by law.

So . . . Now What?

What to do if we have used non-competes?

- Review employment records and identify employees who are subject to restrictive covenants.
- Identify employees with such agreements who are located in California, regardless of where they resided when they entered the agreement
- Prepare and send notices that comply with AB 1076's notice requirement.
- Put in place a notice retention policy to record compliance.
- Update hiring practices, including a review of template employment agreements and offer letters, to assess whether post-employment restrictions must be removed or amended and to ensure that departing employees are provided with the required notice.

Other State Restrictions

Other State Restrictions

- California does not sit on an island in the area of non-competes.
- Non-competes are also banned in Oklahoma, North Dakota, and Minnesota.
  - Minnesota is the most recent adoptee, generally banning non-competes effective July 1, 2023.
  - New York may become the fifth state to ban non-competes and currently has legislation pending to do so.
- Other states such as Colorado, Illinois, Idaho, Maine, Maryland, Massachusetts, Nevada, New Hampshire, Oregon, Rhode Island, Virginia, Washington & Washington D.C. limit non-competes to highly compensated workers, defining that threshold differently.

Other State Restrictions

- Other states impose other sorts of restrictions, such as requiring that employees be advised in writing to consult an attorney, or that the agreement be presented to the employee in advance of the beginning of employment.
    - Massachusetts, Maine, Illinois, Colorado, Oregon, Washington.
- Yet other states limit the enforceability of restrictive covenants by the job position.
    - Georgia restricts enforceable non-competes to customer-facing and sales employees.
    - Missouri prohibits non-solicitation agreements for employees who provide only secretarial or clerical services.

Federal Landscape in Restrictive Covenants

Federal Landscape – President

- Lawmakers are disfavoring non-competes at the federal level as well.
- On July 9, 2021, President Biden issued “Executive Order on Promoting Competition in the American Economy.”
  - Encourages the FTC to “curtail the unfair use of non-compete clauses and other clauses or agreements that may unfairly limit worker mobility.”
  - Arguably broader scope than only non-compete agreements (potentially customer and employee non-solicitation provisions, no-hire provisions, and non-servicing provisions).
  - Encourages regulating “the unfair use” of non-compete clauses and other restrictive covenants (suggesting not all use of such agreements is “unfair).

Federal Landscape – FTC

- On January 5, 2023, FTC proposed rule to ban broadly defined non-compete clauses, superseding all contrary state laws.
- FTC rulemaking process underway.
- Approximately 27,000 comments submitted on draft rule.
- FTC expected to vote **this month** on proposed non-compete ban.

Federal Landscape – NLRB

- On May 30, 2023, NLRB General Counsel issued a memo setting forth her view that the proffer, maintenance, and enforcement of non-compete provisions in employment contracts and severance agreements violate the NLRA except in limited circumstances.
  - Based on interpretation of NLRA Section 8
  - Not (yet) adopted by the Board
  - NLRA applies to private employers, non-supervisory employees

Polling Questions

Does your company have employees outside of California?

Yes

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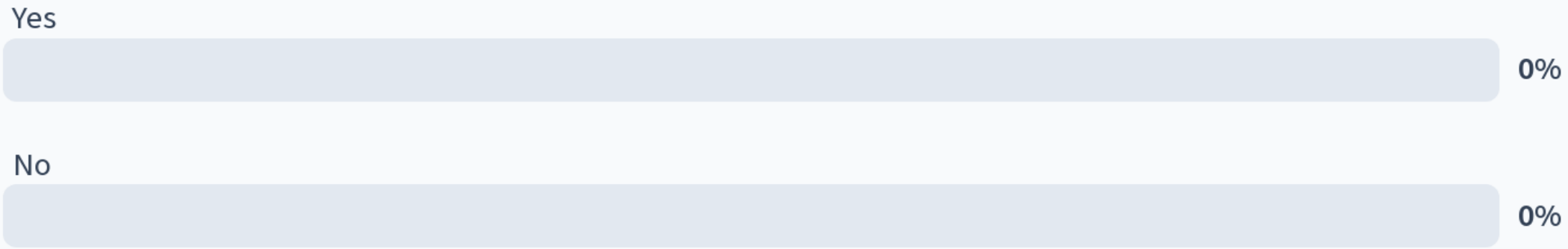
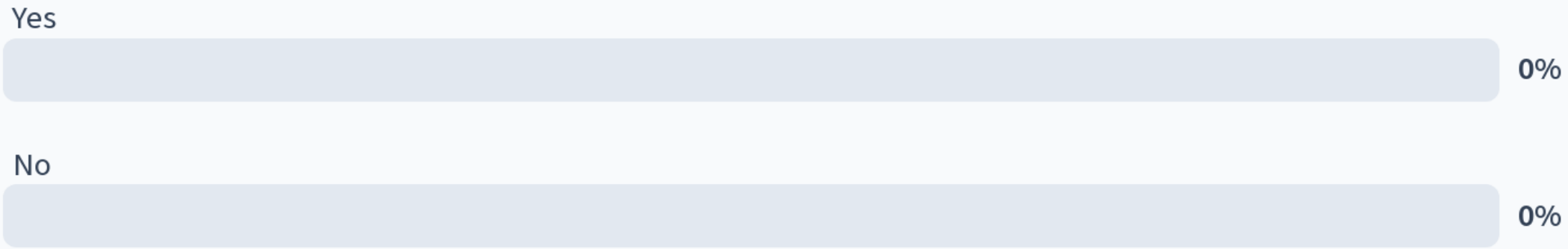
No

0%

Does your company use non-compete agreement for employees outside of California?



Does your company recruit employees from outside of California?



Implications of New California Restrictive Covenant Law

Important Questions Remain Unanswered

- Do these new laws apply to in-term (during employment) restrictive covenants consistent with an employee's duty of loyalty?
- How do these provisions interplay with Labor Code section 925(e), which otherwise permits a represented employee to enter into agreements under the law of another state?
- Do these laws apply to contracts signed before the effective date?
- How will other states and courts enforce these laws, if at all?
- Do these new protections apply to individual contractors and consultants?
- Are employers with employees throughout the U.S. required to give the notice to all employees, not just those in California?

Impact on Non-Solicits

- If AB 1076 applies to non-solicitation agreements, SB 699 may also apply.
  - Possibility of a private suit for forcing an employee to sign an unenforceable non-solicitation agreement.
- AB 1076 may also require employers to notify employees and former employees that non-solicitation clauses to which they previously agreed are void.

Impact on Non-Solicits

- Under AB 1076, Section 16600 will be "read broadly, in accordance with *Edwards v. Arthur Andersen LLP*"
  - In *Edwards*, the Court ruled that a non-compete provision was void where the employee agreed not to perform professional services for clients with whom he worked while with his former employer and not to solicit Arthur Anderson's clients. This was found to restrain him from engaging in their profession, business, or trade.
- A.B. 1076 does not specifically state that it applies to non-solicitation provisions. However, based on the Court's holding in *Edwards*, that likely is the case.

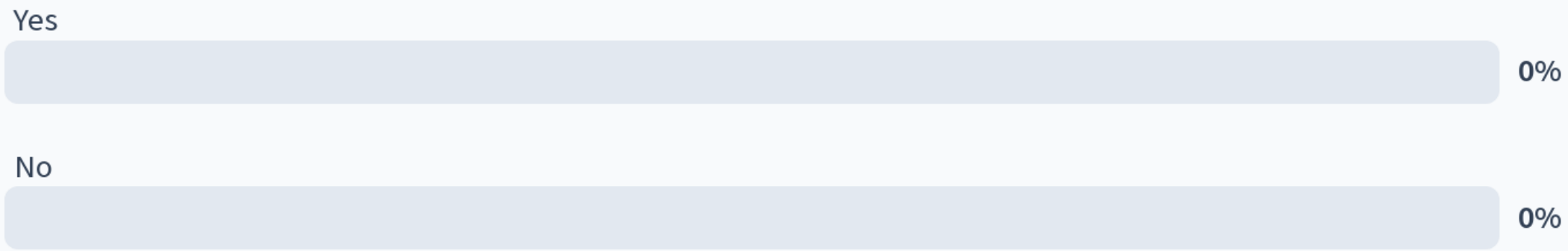
Current State of Non-Solicit Law

- Non-solicit clauses and agreements are invalid and unenforceable if they:
  - Prohibit an employee from engaging in lawful, off-duty conduct;
  - Restrict an employee's right to terminate their employment;
  - Violate an employee's right to work in a particular profession or field; or
  - They are overly broad in scope or duration.

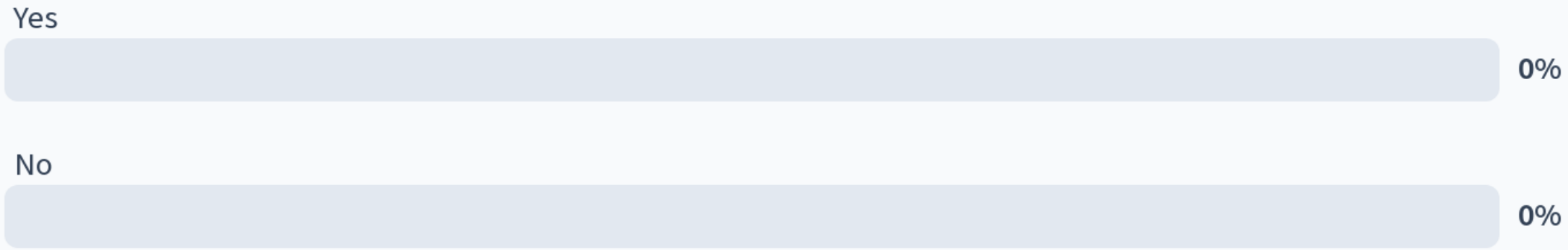
  See, e.g., *Loral Corp. v. Moyes*, 174 Cal.App.3d 268, 219 Cal.Rptr. 836 (Cal. Ct. App. 1985); *Strategix, Ltd. v. Infocrossing W., Inc.*, 142 Cal.App.4th 1068, 48 Cal.Rptr.3d 614 (2006); *VL Sys., Inc. v. Unisen, Inc.*, 152 Cal.App.4th 708, 61 Cal.Rptr.3d 818 (2007); *Dowell v. Biosense Webster, Inc.*, 179 Cal.App.4th 564, 102 Cal.Rptr.3d 1 (2009).

Polling Questions

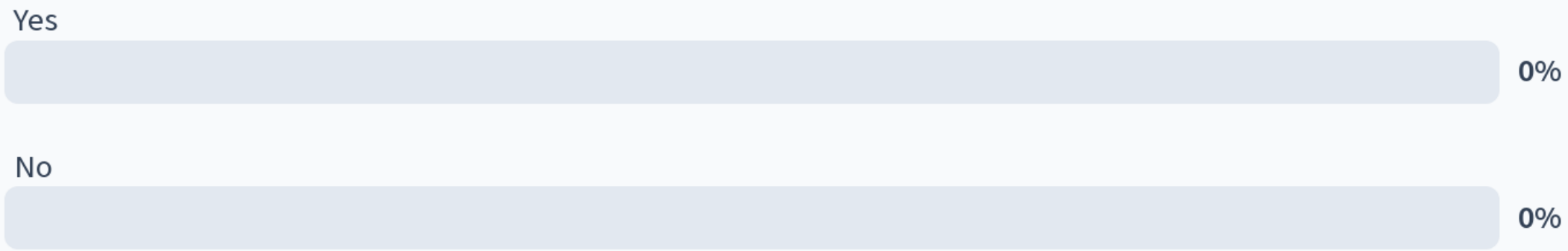
Does your company use non-solicitation agreements?



Does your company use these agreements for reasons ancillary to a sale of part of all of the business?



Does your company use these agreements to protect trade secrets?



Trade Secrets

California's Trade Secret Act (CUTSA)

- The California Uniform Trade Secrets Act (CUTSA), Cal. Civ. Code §§3426.1–.11, was adopted effective January 1, 1985, and amended in 2006, effective Jan. 1, 2007, and is based on the Uniform Trade Secrets Act (UTSA).
- The CUTSA "creates a statutory cause of action for the misappropriation of a trade secret." *Brescia v. Angelin*, 172 Cal. App. 4th 133, 143, 90 Cal. Rptr.3d 842 (2009).

CUTSA "Trade Secret" Definition

- "Trade secret" means information, including a formula, pattern, compilation, program, device, method, technique, or process, that:
  - (a) Derives independent economic value, actual or potential, from not being generally known to the public or to other persons who can obtain economic value from its disclosure or use; and
  - (b) Is the subject of efforts that are reasonable under the circumstances to maintain its secrecy. Cal. Civ. Code § 3426.1 (4)

CUTSA "Misappropriation" Definition

- "Misappropriation" means:
  - (a) Acquisition of a trade secret of another by a person who knows or has reason to know that the trade secret was acquired by improper means; or
  - (b) Disclosure or use of a trade secret of another without express or implied consent by a person who:
    - (I) Used improper means to acquire knowledge of the trade secret; or
    - (II) At the time of disclosure or use, knew or had reason to know that his or her knowledge of the trade secret was:
      - (A) Derived from or through a person who had utilized improper means to acquire it;
      - (B) Acquired under circumstances giving rise to a duty to maintain its secrecy or limit its use; or
      - (C) Derived from or through a person who owed a duty to the person seeking relief to maintain its secrecy or limit its use; or
      - (D) Before a material change of his or her position, knew or had reason to know that it was a trade secret and that knowledge of it had been acquired by accident or mistake.

Defend Trade Secrets Act

- The Defend Trade Secrets Act of 2016 (DTSA), creates a federal private cause of action for trade secret misappropriation.
- The DTSA defines trade secrets and misappropriation consistent with the Uniform Trade Secrets Act (UTSA), which has been adopted in some form by all states (except New York) and the District of Columbia (18 U.S.C. § 1839).

Key Differences between CUTSA and DTSA

- Federal question jurisdiction
- Ex Parte Seizure
- Whistleblower Immunity

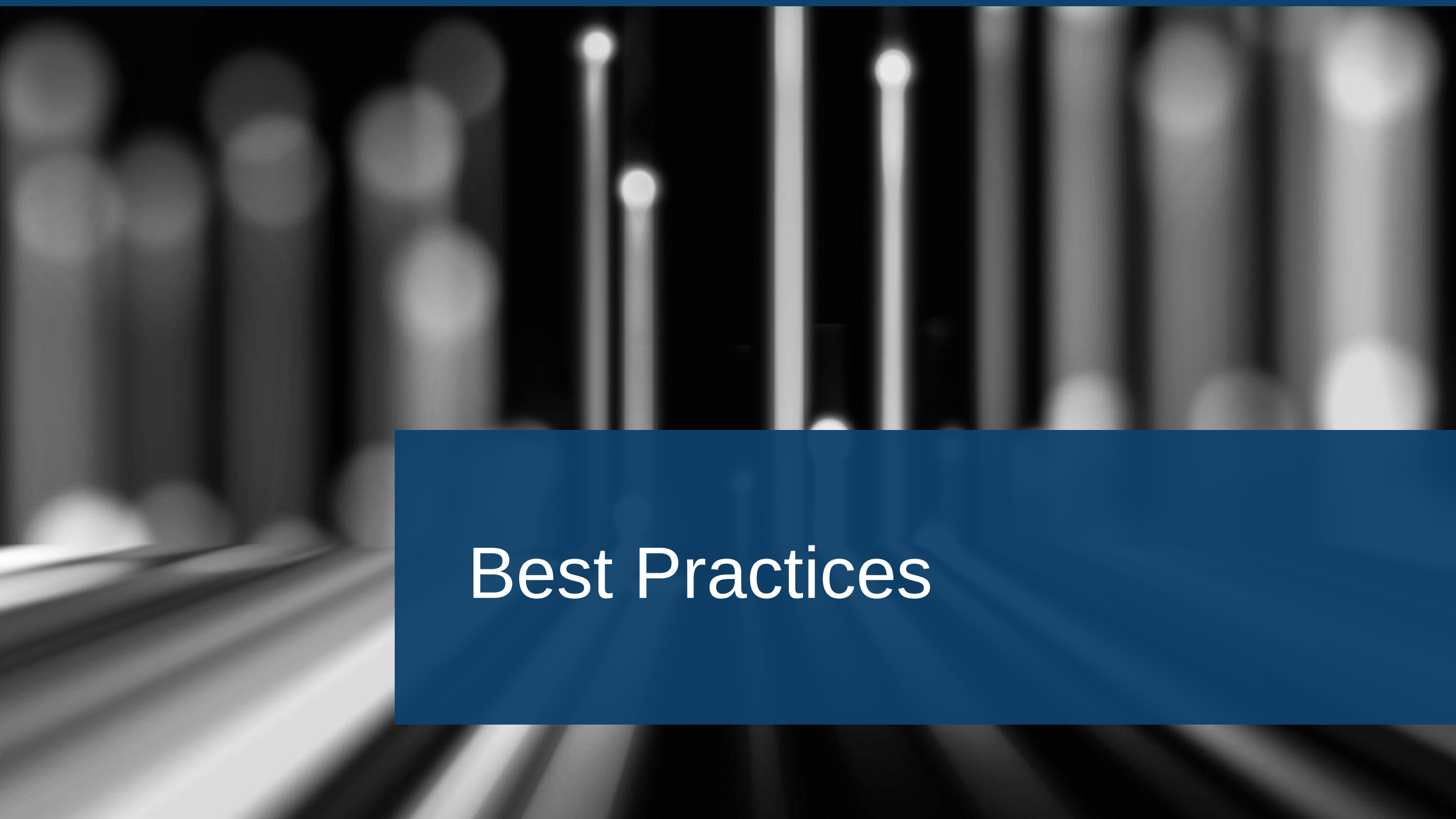
Section 16600 and Trade Secrets

- *Genasys Inc. v. Vector Acoustics LLC*, 638 F. Supp.3d 1135 (S.D. Cal. 2022)
  - Court granted motion to dismiss plaintiff's breach of contract claim against two former employees who left and allegedly started a competing business because the proprietary and inventions agreement required former employees to disclose inventions developed during employment and for one-year after employment, including those related to Genasys' research or development, or resulting from any work performed for Genasys.
  - Court found this agreement too broad and violative of Section 16600.
  - "An Agreement, such as the one involved in the instant case, which requires a former employee to turn over to his former employer all new ideas and concepts concerning the field of work or the products of the employer which occur to him within one year after the termination of his employment is unnecessarily broad." *Citing Armolite Lens Co. v. Campbell*, 340 F. Supp. 273, 275 (S.D. Cal. 1972).

No Consensus under California Law

- *Genasys Inc. v. Vector Acoustics LLC*, 638 F. Supp.3d 1135 (S.D. Cal. 2022)

  "Courts disagree about whether a 'trade secret exception' exists under Section 16600 . *Arthur J. Gallagher & Co. v. Tarantino*, 498 F. Supp. 3d 1155 , 1169 (N.D. Cal. 2020) ("[T]here is not a clear consensus as to whether there is such an exception to § 16600 , although courts still have the ability 'to enjoin the misuse of trade secrets as an independent wrong, either as a tort or a violation of the Unfair Competition Law.'"); *cf. Applied Materials, Inc. v. Advanced Micro-Fabrication Equip. (Shanghai) Co.*, 630 F. Supp. 2d 1084 , 1090 (N.D. Cal. 2009) ("The Court, however, finds that case law amply supports the existence of such a [Section16600] exception."). Such an exception would permit an otherwise invalid employee agreement to stand if "necessary to protect an employer's trade secret." *Gatan, Inc. v. Nion Co.*, No. 15-CV-1862-PJH, [2016 BL 99853], 2016 U.S. Dist. LEXIS 42764 , [2016 BL 99853], 2016 WL 1243477 , at *3 (N.D. Cal. Mar. 30, 2016) (citing *Asset Mktg. Sys., Inc. v. Gagnon*, 542 F.3d 748 , 758 (9th Cir. 2008)). Plaintiff's employee agreements, however, are not necessary to protect Genasys' alleged trade secrets and thus, even if such an exception does exist, Plaintiff's agreements would remain void and unenforceable."



Best Practices

What to do when potential hires are subject to non-competes?

- Review any restrictive covenant agreement provided by a candidate for employment before hiring to determine whether there are contractual restrictions
- Consider enforcement/tortious interference/IP ownership issues
- Protect yourself against claims
  - E.g., collect and save communications in which the employee first contacted Company to seek employment if those will show that the Company did not initially solicit or seek out the employee

What to do during the hiring/onboarding stage?

- Conduct background checks
- Consider conducting court records search to see if the candidate has been alleged to have mishandled or misappropriated confidential information or trade secrets in the past
- Ensure employees review and acknowledge receipt and understanding of the employee handbook that includes language regarding protection of proprietary information
- Ensure confidentiality agreements narrowly define the scope of confidential/trade secret information
- Do not use confidentiality agreements to protect information that is public

What to do during the hiring/onboarding stage?

- Provide an offer letter/employment agreement:
  - Instruct employee not to use/disclose confidential or proprietary information of any former employer/person/entity to whom they have confidentiality obligations.
  - Obtain employee certification: (1) no improper use of any copyrighted material belonging to any former employer; (2) such materials will not be brought on Company premises; (3) employee has searched for and returned such materials to former employer; (4) employee will comply with existing agreements with former employer.
  - Require employee to inform/provide copy of prior restrictive covenant agreement.
  - Require employee to sign restrictive covenants agreement as condition of employment (include confidentiality, invention assignment – non-compete and non-solicit if permitted).

What to do during the hiring/onboarding stage?

- Provide comprehensive training to educate employees about their obligations with respect to handling of company trade secrets and confidential information, including prohibitions against public disclosures through online postings.
- Notice and acknowledgement upon logging into company systems re: exposure to confidential information.
- Consider project-based NDAs.
- Adopt a response protocol for the inadvertent disclosure of Company information.
  - Create policies and procedures to limit employee access and maintain protections to Company trade secrets and confidential information.
  - Invest in Company infrastructure to support adopted policies.

What to do during the hiring/onboarding stage?

- For employees with previous restrictive covenants or confidentiality obligations discuss the importance of not using information from prior employer/third party.
- Make clear that:
  - The company does not want the employee to utilize any proprietary information belonging to another company while doing performing their duties.
  - Even if the employee authored documents in their prior role, that material belongs to their prior employer.
- Create screens internally to protect against disclosure/competitive activities.

What to do during the employment stage?

- Ensure reasonable efforts to protect trade secrets and proprietary information throughout employment and document those efforts.
- Preventative steps:
  - Limit access to such information only to those with a need to know.
  - Establish appropriate security measures.
  - Store and handle Company information in a secure manner.
  - Regularly audit company computer usage – random monitoring.
  - Require regular password changes/encryption.
  - Distribute encrypted storage devices and prevent non-encrypted storage devices from accessing Company systems.
  - Retain right to inspect personal computers/devices/phones.

What to do during the exit stage?

- Perform an exit interview:
  - Remind departing employees of confidentiality agreements and reiterate the company's policy on confidential information and trade secrets.
  - Remind departing employees of continuing obligation to keep company information confidential and request that the employee sign an acknowledgment of continuing obligations.
  - If the employee has not signed a restrictive covenant, consider whether the employee should or can (jurisdiction dependent).

What to do during the exit stage?

- Conduct a forensic analysis of company-issued electronics if necessary.
- Conduct investigation and backup company-issued electronics before terminating an employee who may be misappropriating.
- Secure the company's confidential information by terminating all departing employee access to the company's systems and information.
- Preserve the employee's computer and other electronic devices.
- Conduct a review of whether the employee used their computer or electronic devices to transfer or copy company information.
- Preserve forensic image of device.

Alternatives to non-compete/non-solicitation clauses

- Garden leave provisions requiring employees to give advance notice of resignation and exclude employees from their workplace and active duties while the employee remains employed and owes a continuing duty of loyalty to the employer.
- Forfeiture clauses permitting forfeiture of benefits or other incentives if an employee joins a competitor.
- Clawback provisions requiring employees to repay previously earned compensation if an employee joins a competitor.

Thank You

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