

Restrictive Covenant Developments That Will Shape 2023

Steven J. Pearlman,
Co-Head – Restrictive Covenants and Trade Secrets Practice Group

Joseph O’Keefe,
Co-Head – Restrictive Covenants and Trade Secrets Practice Group

Daryl G. Leon,
Administrative Lead – Restrictive Covenants and Trade Secrets Practice Group

January 19, 2023

Proskauer»



Presenters



Steven J. Pearlman, Partner



Joseph O'Keefe, Partner



Daryl G. Leon, Associate

Agenda

- FTC's historic proposed rule to ban nearly all non-compete agreements.
- History leading to the proposed rule and enhanced federal scrutiny of on-competes.
- Recent enforcement actions and other moves by the FTC to eradicate unfair restrictions.
- Updated "low-wage" thresholds and notice requirements for restrictive covenants.
- Takeaways from the most significant trade secret verdicts, including "avoided costs" remedy.
- Other recent developments.





FTC's Proposed Ban of Non-Competes

Key Features of FTC Proposed Rule

- FTC's January 5 proposed rule mandates the following:
 - **1. Bans non-competes.**
 - Defines “workers” to include employees, independent contractors, interns, volunteers, apprentices, and gig economy workers.
 - Carve out for non-competes between franchisors and franchisees.
 - **2. Voids existing non-competes.**
 - Requires employers to rescind existing non-compete agreements no later than the Compliance Date and provide notice to workers that their non-compete clauses are no longer in effect and may not be enforced.
 - Individualized written notices must be provided to each currently employed worker, as well as former workers for whom the employer retains contact information, within 45 days after rescinding the non-compete clause.
 - Safe harbor for employers who use the model notice language provided in the Proposed Rule.
 - **3. Bans agreements that can be construed as de facto non-competes.**
 - Bans agreements that the FTC determines are written so broadly that they would effectively preclude a worker from working in the same field after the conclusion of employment.

Key Features of FTC Proposed Rule (cont'd)

- FTC's January 5 proposed rule mandates the following: (cont'd)
 - **4. Permits non-competes entered into in connection with the sale of business or of an ownership interest where the person to be restricted owns at least a 25% interest in the company.**
 - **5. Employers may still prohibit competition during employment.**
 - **6. Employers may still use common contractual restrictions such as:**
 - non-disclosure or confidentiality agreements
 - agreements for the repayment of training costs
 - agreements providing for the forfeiture of deferred compensation or benefits by competing workers
 - agreements restricting a worker from soliciting clients, customers, or other workers

Is the FTC Exceeding Its Authority?

- Does the FTC have authority to issue this rule?
 - FTC has authority to prevent unfair competition under Section 5 of the FTC Act ... but,
 - Per *West Virginia v. EPA* (SCOTUS), this appears to be a “major question” that limits the FTC
 - Doctrine requires an administrative agency to have clear congressional authorization before it regulates matters of major economic significance.
 - This appears to be an impermissible delegation of legislative authority under the non-delegation doctrine.
 - This doctrine requires congressional authority to delegate legislative authority to an administrative agency.

Timing

- Proposed rule will not become final until after the close of a 60-day public comment period.
 - Expect extensive comments
 - Expect legal challenges

Practical Implications

- Heightened risk of trade secret misappropriation.
 - What if a confidentiality agreement is invalidated under the “functional” test?
 - Consider the effect on investments in innovation.
- Consider impact in sale of business context where an owner owns less than 25% of the business – they could gain an unfair competitive advantage through maintaining substantial goodwill.

What should employers consider doing now?

- Shore up confidentiality policies.
- Provide routine training regarding access to, use of, and treatment of confidential information.
- Ensure confidential information is retrieved and destroyed for departing employees.
- Limit access to confidential information.
- Incentivize employees to remain employed. Examples include:
 - Stay bonuses
 - Forfeiture/clawback agreements
 - Loan or incentive payments that are forgivable over time or at a single defined maturing date



History leading to the FTC's historic proposed rule and increased federal scrutiny of non-compete agreements

How did we get here?

- **October 2016:** DOJ and FTC issued Joint Antitrust Guidance for Human Resources Professionals.
- **July 9, 2021:** President Joe Biden signed an executive order which encouraged the FTC to limit the “unfair use” of non-competes.
- **August 26, 2022:** FTC’s 2022-2026 Strategic Plan Focuses on Goals Aimed at Non-Competes.
 - Objective 2.1: “Identify, investigate, and take actions against anticompetitive mergers and business practices.”
 - Objective 2.2: “Engage in research, advocacy, and outreach to promote public awareness and understanding of fair competition and its benefits.”
- **November 10, 2022:** FTC issued policy statement expanding its enforcement authority under Section 5 of the Federal Trade Commission Act.



Enhanced Federal Scrutiny of Non-Compete Agreements

Federal action on no-poaching agreements

- *United States v. DaVita Inc.*, No. 1:21-CR-00229-RBJ, 2022 WL 266759, (D. Colo. Jan. 28, 2022).
 - In April 2022, a Colorado jury acquitted Davita Inc. and its former CEO of all charges brought by the DOJ, alleging that it fixed workers' wages and allocated markets by forming a conspiracy with three other owners/operators of outpatient medical facilities agreeing not to solicit each other's workers.
- The DOJ has shown no signs of abating and continued to press criminal indictments in similar cases (*U.S. v. Patel et. al.*, No. 3:21-CR-220 (VAB), 2022 WL 17404509 (D. Conn. Dec. 2, 2022)).

FTC's challenge to ARKO Corp's acquisition

- In June 2022, the FTC challenged an acquisition by Arko Corporation (“Arko”) and its subsidiaries of 60 gasoline and diesel fuel outlets from a competitor, Corrigan Oil Company (“Corrigan”), due to specific non-compete provisions included in the asset purchase agreement.
 - “As part of their \$94 million acquisition of Corrigan assets, ARKO and GPM insisted on a sweeping agreement not to compete covering more than 190 GPM locations in Michigan and Ohio, many of which are completely unrelated to the transaction.” “By keeping Corrigan from competing to sell gasoline and diesel to consumers in these markets, the agreement not to compete harmed customers who otherwise could benefit from this competition.” - Holly Vedova, Director of the Bureau of Competition.
- Arko Corp. and its subsidiary GPM Investments LLC agreed to trim certain noncompete provisions from a deal to buy 60 Michigan and Ohio-based Express Stop retail fuel outlets from Corrigan Oil Company that the Federal Trade Commission deemed anti-competitive.

FTC files suits to stop companies from making workers sign non-compete restrictions

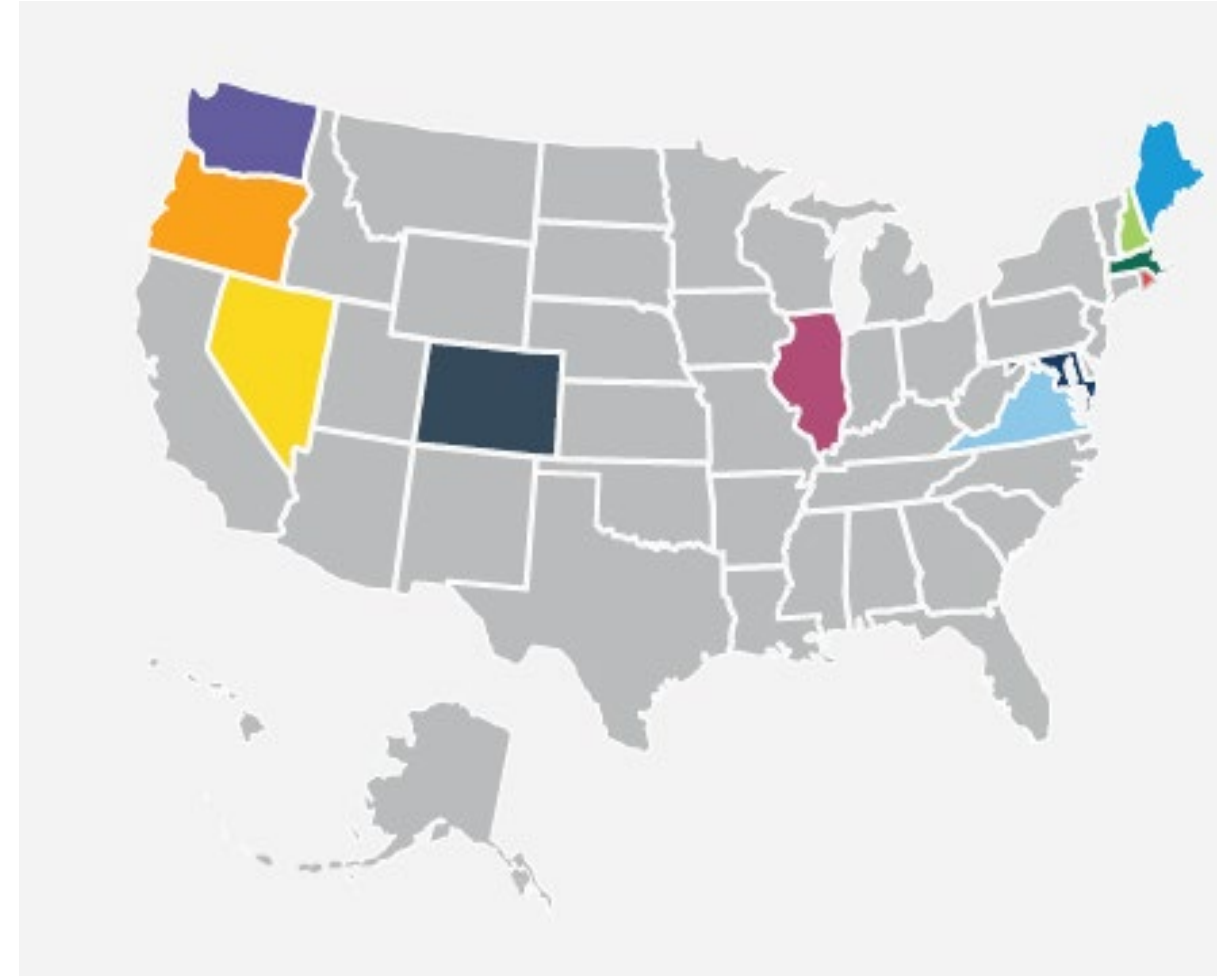
- On **January 4, 2023**, the FTC invoked its recently expanded Section 5 authority and brought actions against three companies to halt their allegedly unlawful use of non-competes.
- FTC said Prudential, Michigan-based security companies, "exploited their superior bargaining power against low-wage security guards."
 - Prudential required workers to sign contracts that prevented them from working for competing businesses within 100 miles of their job site for 2 years after leaving the company and required employees to pay \$100,000 if they violated the company's clause.
- The FTC also claimed O-I Glass Inc. and Ardagh Group S.A. imposed 1-2 year non-competes on thousands of workers who worked in various roles, locking up highly specialized workers and reducing labor mobility in a highly-concentrator sector of the economy.



Low-wage Restrictive Covenant Thresholds

2023 state-by-state restrictions and salary thresholds

- There are now **eleven** states (plus **Washington, D.C.**) that impose wage thresholds for non-competes.
 - *Colorado;
 - *District of Columbia;
 - *Illinois;
 - Maine;
 - Maryland;
 - Massachusetts;
 - New Hampshire;
 - Nevada;
 - Oregon;
 - Rhode Island;
 - Virginia; and
 - Washington.



2023 wage thresholds

Washington, D.C.: Non-competes are prohibited for employees who make less than \$150,000 per year.

Colorado: Prohibition on non-competes for employees earning less than \$112,500 per year. Customer non-solicits may not be used if the employee does not earn \$67,500 per year.

Illinois: Prohibition on: (i) non-competes for employees who earn less than \$75,000 per year; and (ii) non-solicits for employees who earn less than \$45,000 per year.

2023 wage thresholds (cont'd)

Maryland: Prohibition on non-competes for employees who earn equal to or less than: (i) \$15 per hour; or (ii) \$31,200 per year.

New Hampshire: Prohibition on non-competes for employees who earn (i) an hourly wage less than or equal to 200 percent of the federal minimum wage, (\$14.50 or less per hour, or \$30,160 or less per year); or (ii) less than or equal to 200 percent of the tipped minimum wage in the state.

Maine: Prohibition on non-competes for employees earning wages at or below 400 percent of the federal poverty level, currently \$58,320 per year.

2023 wage thresholds (cont'd)

Oregon: Non-competes with employees are void unless, among other things: (i) the exempt employee's annual salary at the time of termination exceeds \$100,533 (adjusted annually for inflation); and (ii) the agreement is limited to a one-year duration.

Rhode Island: Prohibition on non-competes for: (i) non-exempt employees; (ii) undergraduate or graduate students participating in internships or short-term employment; (iii) employees under the age of 19; and (iv) employees whose average annual earnings (excluding overtime, Sunday, or holiday premiums) are less than 250 percent of the federal poverty level, or \$36,450 per year.

Virginia: Employers are prohibited from entering into non-competes with employees who earn less than Virginia's average weekly wage: \$1,290 per week or \$67,080 per year.

Washington: Prohibition on non-competes for (i) employees who earn less than \$116,593.18 per year (adjusted annually for inflation); and (ii) independent contractors who earn less than \$291,482.95 per year (adjusted annually for inflation).

2023 wage thresholds (cont'd)

Massachusetts: Prohibition on non-competes for: (i) non-exempt employees; (ii) undergraduate or graduate students participating in internships or short-term employment; (iii) employees that have been terminated without cause or laid off; and (iv) employees under the age of 18.

Nevada: Prohibition on non-competes for employees who are paid solely on an hourly wage basis, exclusive of tips or gratuities.



Restrictive Covenant Notice Requirements

New notice requirements

- **Colorado**

- Must present the non-compete agreement and its terms to prospective workers before prospective worker accepts an offer of employment.
- Must give current workers a copy of the non-compete and its terms at least 14 days before the earlier of either 1) the effective date of the covenant; or 2) the effective date of any additional compensation or a change in the conditions of employment that provides consideration for the covenant.

- **Illinois**

- Must provide a copy of the non-compete 14 days before signing; and
- Must advise an employee in writing to consult with an attorney before entering the covenant.

New notice requirements (cont'd)

- **Washington D.C.**
 - Must provide eligible (i.e., high-wage) employees and applicants with a written copy of the non-compete provision and a written disclosure containing statutorily required language.
 - Must give prospective high-wage employees at least 14 days before the individual commences employment.
 - Must give current high-wage employees at least 14 days before the employee must execute the agreement.

Existing notice requirements

- **Oregon**

- Must give a prospective employee at least 2 weeks' notice before their first day of work in a written employment offer that a non-compete agreement is required as a condition of employment.

- **New Hampshire**

- Must provide prospective employees with a copy of the required non-compete agreement prior to or concurrent with making an offer of employment.
- Must provide employees with a copy of the required non-compete agreement prior to or concurrent with making an offer of change in job classification.

- **Massachusetts**

- Must provide the non-compete agreement to prospective employees by the earlier of 1) a formal offer of employment; or 2) 10 business days before commencement of employee's employment.
- Must provide the non-compete agreement to current employees at least 10 days before the agreement is effective.

Existing notice requirements (cont'd)

- **Maine**

- Must disclose that acceptance of a non-compete agreement will be required before making an offer of employment; and
- Must provide current and prospective employees a copy of the agreement itself at least three (3) business days before the deadline to sign.

- **Washington**

- Must disclose the terms of the non-compete in writing no later than when the prospective employee accepts the job offer.
- Must also disclose that the non-compete may become enforceable at a later date due to changes in compensation (if applicable).



The Most Significant Trade Secret Verdicts of 2022

Sky-high verdicts reveal growing trends in damages theories

Appian Corp. v. Pegasystems Inc.,
No. 2020-07216 (Va. Cir. Ct. Fairfax
Cty. May 9, 2022)

- the jury awarded a staggering **\$2 billion** in favor of plaintiff Appian for misappropriation of trade secrets in violation of the Virginia Trade Secrets Act and Virginia Computer Crimes Act, in addition to willful and malicious misappropriation.

Versata Software Inc. v. Ford Motor Co., No. 2:15-cv-10628 (E.D. Mich.
Oct. 26, 2022)

- the jury awarded Versata Software **\$105 million** for its breach of contract and misappropriation of trade secrets claims against Ford Motor Co. on the theory that Ford had misappropriated software developed by Versata utilized in managing how Ford vehicles are assembled.

Coda Development SRO v. Goodyear Tire & Rubber Co., No. 5:15-cv-1572 (N.D. Ohio Sept. 19, 2022)

- the jury awarded Coda Development **\$64 million** for the misappropriation of trade secrets involving self-inflating tires after Coda Development and Goodyear had discussed a potential collaboration.

Comet Technologies USA Inc. v. XP Power LLC, No. 20-cv-06408 (N.D. Cal. Mar. 23, 2022)

- Comet Technologies was awarded **\$40 million** for the misappropriation of trade secrets related to the manufacture of semiconductor chips, which Comet alleged occurred after XP hired away Comet employees who were aware of the proprietary technology.

Developing “avoided costs” theory of damages

- The DTSA and UTSA allow for damages for unjust enrichment caused by the misappropriation of the trade secret that is not addressed in computing damages for actual loss.
 - UTSA adopted in every U.S. state except New York and North Carolina.
- “Avoided costs” are the costs that the thieving party has avoided by taking the completed trade secret.
- *Appian Corp. v. Pegasystems Inc.*, No. 2020-07216 (Va. Cir. Ct. Fairfax Cty. May 9, 2022).
- *Comet Technologies USA Inc. v. XP Power LLC*, No. 20-cv-06408 (N.D. Cal. Mar. 23, 2022).
- *Medimpact Healthcare Sys. v. IQVIA Inc.*, No. 19cv1865-GPC(DEB), 2022 U.S. Dist. LEXIS 186470, at *1 (S.D. Cal. Oct. 7, 2022).

Developing “avoided costs” theory of damages (cont’d)

- Multi-million dollar unjust enrichment verdicts upheld by the 3rd and 6th Circuit Courts of Appeals.
 - *PPG Indus. v. Jiangsu Tie Mao Glass Co.*, 2022 U.S. App. LEXIS 24411 (3d Cir. Aug. 30, 2022).
 - Upheld a \$26.4 million dollar award.
 - Held that injunctive relief and monetary damages can coexist.
 - *Caudill Seed & Warehouse Co. v. Jarrow Formulas, Inc.*, 53 F.4th 368 (6th Cir. 2022).
 - \$2,023,000 in compensatory damages.
 - \$404,605 in unjust enrichment damages.
 - The district court further awarded \$1,000,000 in exemplary damages, \$3,254,303.50 in attorney fees, and \$69,871.82 in costs against Jarrow.
 - Total award of nearly \$7,000,000.
- Theory rejected by some state courts: *E.J. Brooks Co. v. Cambridge Security Seals*, No. 26, 2018 BL 157167 (N.Y. May 3, 2018).



Recent State Law Developments

Other Recent Developments

- **Proposed Legislation in New Jersey.**
- **Remote Work and Impact on Non-Competes.**
 - *Onward Search LLC v. Noble*, 3:22-cv-00369 (D. Conn. Jul. 11, 2022).
- **Recently, the Delaware Court of Chancery issued two important (and surprising) decisions invalidating restrictive covenants in two contexts.**
 - The sale of a business (*Kodiak Building Partners, LLC v. Adams, C.A.*, Oct. 6, 2022).
 - Financial services compensation arrangements (*Ainslie v. Cantor Fitzgerald, LP*, Jan. 4, 2023).
- **First restrictive covenant class action.**



Contacts

Steven J. Pearlman, Co-Head –
Restrictive Covenants and Trade Secrets Practice Group
312-962-3545 | spearlman@proskauer.com

Joseph O’Keefe, Co-Head –
Restrictive Covenants and Trade Secrets Practice Group
212.969.3019 | jokeefe@proskauer.com

Daryl G. Leon, Administrative Lead –
Restrictive Covenants and Trade Secrets Practice Group
212-969-3262 | dleon@proskauer.com

